SUMMIT FINANCIAL GROUP INC
Form 10-K
February 26, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

Commission File Number 0-16587

Summit Financial Group, Inc.
(Exact name of registrant as specified in its charter)

West Virginia (State or other jurisdiction of incorporation or organization)	55-0672148 (I.R.S. Employer Identification No.)
300 N. Main Street Moorefield, West Virginia (Address of principal executive offices)	26836 (Zip Code)

(304) 530-1000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common
(Title of Class)

The NASDAQ Capital Market
(Name of Exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ¨ No þ

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.   Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. ¨

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o		Accelerated filer þ
Non-accelerated filer o	(Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the voting common equity held by non-affiliates of the registrant at June 30, 2015, was approximately $95,090,000. Registrant has assumed that all of its executive officers and directors are affiliates. Such assumption shall not be deemed to be conclusive for any other purpose.

The number of shares of the Registrant's Common Stock outstanding on February 25, 2016 was 10,853,566.

Documents Incorporated by Reference

The following lists the documents which are incorporated by reference in the Annual Report Form 10-K, and the Parts and Items of the Form 10-K into which the documents are incorporated.

Document	Part of Form 10-K into which document is incorporated
Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 19, 2016	Part III - Items 10, 11, 12, 13, and 14

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PART I.

Item 1. Business

Summit Financial Group, Inc. (“Company” or “Summit”) is a $1.49 billion financial holding company headquartered in Moorefield, West Virginia incorporated on March 5, 1987. We provide community banking services primarily in the Eastern Panhandle and South Central regions of West Virginia and the Shenandoah Valley and Northern region of Virginia. We provide these services through our community bank subsidiary, Summit Community Bank (“Summit Community” or “Bank”). We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia, which provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty insurance products, as well as group health and life insurance products and consulting services.

Community Banking

We provide a wide range of community banking services, including demand, savings and time deposits; commercial, real estate and consumer loans; letters of credit; and cash management services. The deposits of Summit Community are insured by the Federal Deposit Insurance Corporation ("FDIC").

In order to compete with other financial service providers, we principally rely upon personal relationships established by our officers, directors and employees with our clients, and specialized services tailored to meet our clients’ needs. We have maintained a strong community orientation by, among other things, supporting the active participation of staff members in local charitable, civic, school, religious and community development activities. We also have a marketing program that primarily utilizes local radio and newspapers to advertise. Banking, like most industries, is becoming more dependent on technology as a means of marketing to customers, including the Internet, which we also utilize. This approach, coupled with continuity of service by the same staff members, enables Summit Community to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs. We believe that our emphasis on local relationship banking, together with a prudent approach to lending, are important factors in our success and growth.

All operational and support functions that are transparent to clients are centralized in order to achieve consistency and cost efficiencies in the delivery of products and services by each banking office. The central office provides services such as data processing, deposit operations, accounting, treasury management, loan administration, loan review, compliance, risk management and internal auditing to enhance our delivery of quality service. We also provide overall direction in the areas of credit policy and administration, strategic planning, marketing, investment portfolio management, human resources administration, and other financial and administrative services. The banking offices work closely with us to develop new products and services needed by their customers and to introduce enhancements to existing products and services.

Lending

Our primary lending focus is providing commercial loans to local businesses with annual sales generally ranging from $300,000 to $30 million and providing owner-occupied real estate loans to individuals. Typically, our customers have financing requirements between $50,000 and $5 million. We generally do not seek loans of more than $10 million but will consider larger lending relationships exhibiting above-average credit quality. Under our commercial banking strategy, we focus on offering a broad line of financial products and services to small and medium-sized businesses through full service banking offices. Summit Community Bank has senior management with extensive lending experience. These managers exercise substantial authority over credit and pricing decisions, subject to loan committee approval for larger credits.

We segment our loan portfolio in to the following major lending categories: commercial, commercial real estate, construction and development, residential real estate, and consumer. Commercial loans are loans made to commercial borrowers that are not secured by real estate. These encompass loans secured by accounts receivable, inventory, and equipment, as well as unsecured loans. Commercial real estate loans consist of commercial mortgages, which generally are secured by nonresidential and multi-family residential properties. Commercial real estate loans are made to many of the same customers and carry similar industry risks as the commercial loan portfolio. Construction and development loans are loans made for the purpose of financing construction or development projects. This portfolio includes commercial and residential land development loans, one-to-four family housing construction, both pre-sold and speculative in nature, multi-family housing construction, non-residential building construction, and undeveloped land. Residential real estate loans are mortgage loans to consumers and are secured primarily by a first lien deed of trust. These loans are traditional one-to-four family residential mortgages. Also included in this category of loans are second liens on one-to-four family properties, commercial loans secured by one-to-four family residence, and home equity loans. Consumer loans are loans that establish consumer credit that is granted for the consumer's personal use. These loans include automobile loans and recreational vehicle loans, as well as personal secured and unsecured loans.

Our loan underwriting guidelines and standards are consistent with the prudent banking practices applicable to the relevant exposure and are updated periodically and presented to the Board of Directors for approval. The purpose of these standards and guidelines are: to grant loans on a sound and collectible basis; to invest available funds in a safe and profitable manner; to serve the legitimate credit needs of our primary market area; and to ensure that all loan applicants receive fair and equal treatment in the lending process. It is the intent of the underwriting guidelines and standards to: minimize losses by carefully investigating the credit history of each applicant; verify the source of repayment and the ability of the applicant to repay; collateralize those loans in which collateral is deemed to be required; exercise care in the documentation of the application, review, approval, and origination process; and administer a comprehensive loan collection program.

Our real estate underwriting loan-to-value ("LTV") policy limits are at or below current bank regulatory guidelines, as follows:

	Regulatory LTV Guideline	Summit LTV Policy Limit
Undeveloped land	65%	65%
Land development	75%	70%
Construction:		
Commercial, multifamily, and other non-residential	80%	80%
1-4 family residential, consumer borrower	85%	85%
1-4 family residential, commercial borrower	85%	80%
Improved property:		
Residential real estate - nonowner occupied	85%	85%
Commercial real estate - owner occupied	85%	85%
Commercial real estate - nonowner occupied	85%	85%
Owner occupied 1-4 family	90%	90%
Home equity	90%	90%

Exceptions are permitted to these regulatory guidelines as long as such exceptions are identified, monitored, and reported to the Board of Directors at least quarterly, and the total of such exceptions do not exceed 100% of Summit Community's total regulatory capital, which totaled $169.6 million as of December 31, 2015. As of this date, we had loans approximating $54.9 million which exceeded the above regulatory LTV guidelines, as follows:

Undeveloped land	$1.7	million
Land development	$2.2	million
Construction:		
Commercial, multifamily, and other non-residential	$—	
1-4 family residential, consumer borrower	$—	
1-4 family residential, commercial borrower	$—	
Improved property:		
Residential real estate - nonowner occupied	$3.9	million
Commercial real estate - owner occupied	$24.1	million
Commercial real estate - nonowner occupied	$11.4	million
Owner occupied 1-4 family	$10.5	million
Home equity	$1.1	million

Our underwriting standards and practice are designed to originate both fixed and variable rate loan products, consistent with the underwriting guidelines discussed above. Adjustable rate and variable rate loans are underwritten, giving consideration both to the loan's initial rate and to higher assumed rates, commensurate with reasonably anticipated market conditions. Accordingly, we want to insure that adequate primary repayment capacity exists to address both future increases in interest rates and fluctuations in the underlying cash flows available for repayment. Historically, we have not offered "payment option ARM" loans. Further, we have had no loan portfolio products which were specifically designed for "sub-prime" borrowers (defined as consumers with a credit score of less than 599).

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Supervision and Regulation

General

We are subject to regulation by the Board of Governors of the Federal Reserve System ("FRB"), the West Virginia Division of Financial Institutions, the Securities and Exchange Commission (the "SEC"), and other federal and state regulators. As a financial holding company, we are subject to the restrictions of the Bank Holding Company Act of 1956, as amended ("BHCA"), are registered pursuant to its provisions, and are subject to examination by the FRB. As a financial holding company doing business in West Virginia, we are also subject to regulation by and must submit annual reports to the West Virginia Division of Financial Institutions.

The BHCA prohibits the acquisition by a financial holding company of direct or indirect ownership of more than five percent (5%) of the voting shares of any bank within the United States without prior approval of the FRB. With certain exceptions, a financial holding company is prohibited from acquiring direct or indirect ownership or control of more than five percent (5%) of the voting shares of any company that is not a bank, and from engaging directly or indirectly in business unrelated to the business of banking or managing or controlling banks.

The FRB, in its Regulation Y, permits financial holding companies to engage in non-banking activities closely related to banking or managing or controlling banks. Approval of the FRB is necessary to engage in these activities or to make acquisitions of corporations engaging in these activities as the FRB determines whether these acquisitions or activities are in the public interest. In addition, by order, and on a case by case basis, the FRB may approve other non-banking activities.

The BHCA permits us to purchase or redeem our own securities. However, Regulation Y provides that prior notice must be given to the FRB if the total consideration for such purchase or consideration, when aggregated with the net consideration paid by us for all such purchases or redemptions during the preceding 12 months is equal to ten percent (10%) or more of our consolidated net worth. Prior notice is not required if (i) both before and immediately after the redemption, the financial holding company is well capitalized; (ii) the financial holding company is well managed and (iii) the financial holding company is not the subject of any unresolved supervisory issues.

The FRB has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries that represent unsafe and unsound banking practices or which constitute violations of laws or regulations. The FRB also can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1 million for each day the activity continues.

Summit Community, our only bank subsidiary, is subject to West Virginia banking statutes and regulations, and is primarily regulated by the West Virginia Division of Financial Institutions and the Federal Deposit Insurance Corporation ("FDIC"). The Bank is also subject to regulations promulgated by the FRB. As a member of the FDIC, Summit Community's deposits are insured as required by federal law. Bank regulatory authorities regularly examine revenues, loans, investments, management practices, and other aspects of Summit Community. These examinations are conducted primarily to protect depositors and not shareholders. In addition to these regular examinations, the Bank must furnish to regulatory authorities quarterly reports containing full and accurate statements of its affairs.

Because we are a public company, we are subject to regulation by the SEC. SEC regulations require us to disclose certain types of business and financial data on a regular basis to the SEC and to our shareholders. We are required to file annual, quarterly and current reports with the SEC. We prepare and file an annual report on Form 10-K with the SEC that contains detailed financial and operating information, as well as a management response to specific questions about our operations. SEC regulations require that our annual reports to shareholders contain certified financial statements and other specific items such as management's discussion and analysis of our financial condition and results of operations. We must also file quarterly reports with the SEC on Form 10-Q that contain detailed financial and operating information for the prior quarter and we must file current reports on Form 8-K to provide the pubic with information on recent material events.

In addition to periodic reporting to the SEC, we are subject to proxy rules and tender offer rules issued by the SEC. Our officers, directors and principal shareholders (holding 10% or more of our stock) must also submit reports to the SEC regarding their holdings of our stock and any changes to such holdings, and they are subject to short-swing profit liability. Because we are traded on the NASDAQ, we are also subject to the listing standards of NASDAQ.

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Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, sweeping financial regulatory reform legislation, entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”), was signed into law. The Dodd-Frank Act, which is complex and broad in scope, established the Bureau of Consumer Financial Protection (the “CFPB”), which has extensive regulatory and enforcement powers over consumer financial products and services, and the Financial Stability Oversight Council, which has oversight authority for monitoring systemic risk. We will be required to comply with the Consumer Financial Protection Act and the CFPB’s rules; however, these rules will be enforced by our primary regulator, the FRB, not the CFPB. In addition, the Dodd-Frank Act alters the authority and duties of the federal banking and securities regulatory agencies, implements certain corporate governance requirements for all public companies, including financial institutions with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions, and restricts certain proprietary trading and hedge fund and private equity activities of banks and their affiliates. Although the regulations that directly affect our business have been adopted, many of the provisions of the Dodd-Frank Act are subject to final rulemaking by the U.S. financial regulatory agencies, and the implications of the Dodd-Frank Act for our business will depend to some extent on how such rules are adopted and implemented by the primary U.S. financial regulatory agencies.

Bank Holding Company Activities

In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. In addition, bank holding companies that qualify and elect to be financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity (as determined by the FRB in consultation with the Secretary of the Treasury) or (ii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as solely determined by the FRB), without prior approval of the FRB.

Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and making merchant banking investments. Some examples of non-banking activities which presently may be performed by a financial holding company are: making or acquiring, for its own account or the account of others, loans and other extensions of credit; operating as an industrial bank, or industrial loan company, in the manner authorized by state law; servicing loans and other extensions of credit; performing or carrying on any one or more of the functions or activities that may be performed or carried on by a trust company in the manner authorized by federal or state law; acting as an investment or financial advisor; leasing real or personal property; making equity or debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and the development of low income areas; providing bookkeeping services or financially oriented data processing services for the holding company and its subsidiaries; acting as an insurance agent or a broker; acting as an underwriter for credit life insurance, which is directly related to extensions of credit by the financial holding company system; providing courier services for certain financial documents; providing management consulting advice to non-affiliated banks; selling retail money orders having a face value of not more than $1,000, traveler’s checks and U.S. savings bonds; performing appraisals of real estate; arranging commercial real estate equity financing under certain limited circumstances; providing securities brokerage services related to securities credit activities; underwriting and dealing in government obligations and money market instruments; providing foreign exchange advisory and transactional services; and acting, under certain circumstances, as futures commission merchant for non-affiliated persons in the execution and clearance on major commodity exchanges of futures contracts and options.

To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be “well capitalized” and “well managed.” A depository institution subsidiary is considered to be “well capitalized” if it satisfies the requirements for this status discussed in the section captioned “Capital Requirements” included elsewhere in this item. A depository institution subsidiary is considered “well managed” if it received a composite rating and management rating of at least “satisfactory” in its most recent examination. A financial holding company’s status will also depend upon it maintaining its status as “well capitalized” and “well managed’ under applicable FRB regulations. If a financial holding company ceases to meet these capital and management requirements, the FRB’s regulations provide that the financial holding company must enter into an agreement with the FRB to comply with all applicable capital and management requirements. Until the financial holding company returns to compliance, the FRB may impose limitations or conditions on the conduct of its activities, and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the FRB. If the company does not return to compliance within 180 days, the FRB may require divestiture of the holding company’s depository institutions. Bank holding companies and banks must also be both well capitalized and well managed in order to acquire banks located outside their home state.

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In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the Community Reinvestment Act. See the section captioned “Community Reinvestment Act” included elsewhere in this item.

The FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The Dodd-Frank Act amends the BHC Act to require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule”. The Volcker Rule became effective on July 21, 2012. On December 10, 2013, the Federal Reserve adopted final rules implementing the Volcker Rule. Compliance with the final rule became effective on April 1, 2014; however, the Federal Reserve issued an order on December 18, 2014 extending the period which institutions have to conform their activities and investments to the requirements of the Volcker Rule to July 21, 2016. The Federal Reserve also announced its intention to grant an additional one-year extension of the conformance period until July 21, 2017. On January 14, 2014, the banking agencies approved an interim rule to permit banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities from the investment prohibitions of the Volcker Rule. Although we continue to evaluate the impact of the Volcker Rule and the final rules adopted thereunder, we do not anticipate that the Volcker Rule will have a material effect on our operations as we do not generally engage in the activities prohibited by the Volcker Rule. We may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material.

The BHC Act, the Bank Merger Act, the West Virginia Banking Code and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition by a bank holding company of more than 5.0% of the voting shares of a commercial bank or its parent holding company. Under the Bank Merger Act, the prior approval of the FRB or other appropriate bank regulatory authority is required for a member bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant’s performance record under the Community Reinvestment Act (see the section captioned “Community Reinvestment Act” included elsewhere in this item) and its compliance with fair housing and other consumer protection laws and the effectiveness of the subject organizations in combating money laundering activities.

Dividends

The principal source of our liquidity is dividends from Summit Community. The prior approval of the Federal Reserve is required if the total of all dividends declared by a state-chartered member bank in any calendar year would exceed the sum of the bank’s net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus or to fund the retirement of preferred stock. Federal law also prohibits a state-chartered, member bank from paying dividends that would be greater than the bank’s undivided profits. Summit Community is also subject to limitations under West Virginia state law regarding the level of dividends that may be paid.

In addition, the Company and Summit Community are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal regulatory authority is authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. The appropriate federal regulatory authorities have stated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings.

Credit and Monetary Policies and Related Matters

Summit Community is affected by the fiscal and monetary policies of the federal government and its agencies, including the FRB. An important function of these policies is to curb inflation and control recessions through control of the supply of money and credit. The operations of Summit Community are affected by the policies of government regulatory authorities, including the FRB, which regulates money and credit conditions through open-market operations in United States Government and Federal agency securities, adjustments in the discount rate on member bank borrowings, and requirements against deposits and regulation of interest rates payable by member banks on time and savings deposits. These policies have a significant influence on the growth and distribution of loans, investments and deposits, and interest rates charged on loans, or paid for time and savings deposits, as well as yields on investments. The FRB has had a significant effect on the operating results of commercial banks in the past and is expected to continue to do so in the future. Future policies of the FRB and other authorities and their effect on future earnings cannot be predicted.

The FRB has a policy that a financial holding company is expected to act as a source of financial and managerial strength to each of its subsidiary banks and to commit resources to support each such subsidiary bank. Under the source of strength doctrine, the FRB may require a financial holding company to contribute capital to a troubled subsidiary bank, and may charge the financial holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. This capital injection may be required at times when Summit may not have the resources to provide it. Any capital loans by a holding company to any subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In addition, the Crime Control Act of 1990 provides that in the event of a financial holding company's bankruptcy, any commitment by such holding company to a Federal bank or thrift regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Capital Requirements

Regulatory Capital Rules in Effect Year End 2014. As a financial holding company, we are subject to FRB risk-based capital guidelines. The federal regulatory authorities' current risk-based capital guidelines are based upon the 1988 capital accord ("Basel I") of the Basel Committee on Banking Supervision (the "Basel Committee"). The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, takes off-balance sheet exposures into explicit account in assessing capital adequacy, and minimizes disincentives to holding liquid, low-risk assets. Under the guidelines and related policies, financial holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. Summit Community is subject to substantially similar capital requirements adopted by its applicable regulatory agencies.

Under the requirements, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution's or holding company's capital, in turn, is classified in one of two tiers, depending on type:

- Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in equity accounts of consolidated subsidiaries (and, under existing standards, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level), less goodwill, most intangible assets and certain other assets.

- Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for loan and lease losses, subject to limitations.

We, like other financial holding companies, currently are required to maintain Tier 1 capital and "total capital" (the sum of Tier 1 and Tier 2 capital) equal to at least 4.0% and 8.0%, respectively, of our total risk-weighted assets (including various off-balance-sheet items, such as letters of credit). Summit Community, like other depository institutions, is required to maintain similar capital levels under capital adequacy guidelines. In addition, for a depository institution to be considered "well capitalized" under the regulatory framework for prompt corrective action, its Tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively.

Financial holding companies and banks are also currently required to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's Tier 1 capital to its total adjusted quarterly average assets (as defined for regulatory purposes). The requirements necessitate a minimum leverage ratio of 3.0% for bank holding companies and member banks that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority's risk-adjusted measure for market risk. All other bank holding companies and member banks are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In addition, for a

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depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its leverage ratio must be at least 5.0%.

Our regulatory capital ratios and Summit Community’s capital ratios as of year end 2015 are set forth in the table in Note 18 of the notes to the consolidated financial statements beginning on page 85.

Basel III Capital Rules Effective Beginning 2015. In July 2013, the Company’s and Summit Community’s federal banking regulators published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee’s December 2010 framework known as “Basel III” for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to financial holding companies and depository institutions, including the Company and Summit Community, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions’ regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions’ regulatory capital ratios and replace the existing risk-weighting approach, which was derived from the Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee’s 2004 “Basel II” capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies’ rules. The Basel III Capital Rules were effective for the Company and Summit Community on January 1, 2015 (subject to a phase-in period).

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”), (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expand the scope of the deductions/adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and Summit Community to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets (as compared to a current minimum leverage ratio of 3% for banking organizations that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority’s risk-adjusted measure for market risk).

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face regulatorily prescribed limitations on dividend payments, discretionary payments on tier 1 capital instruments, share buybacks, and discretionary bonus payments to certain Company officers based on the amount of the shortfall.

Under the Basel III Capital Rules, the initial minimum capital ratios as of January 1, 2015 are as follows:

- 4.5% CET1 to risk-weighted assets.
- 6.0% Tier 1 capital to risk-weighted assets.

- 8.0% Total capital to risk-weighted assets.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Furthermore, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios under current capital standards. However, under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, certain banking organizations, including the Company and Summit Community, may make a one-time permanent election to continue to exclude these items. The Company and Summit Community expect to make this election in order to minimize variations in the level of capital.

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The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies, subject to phase-out. However, for holding companies of depository institutions with less than $15 billion in consolidated total assets as of December 31, 2009, the rules do not require a phase out of trust preferred securities issued prior to May 19, 2010. This means that all of our trust preferred securities are permanently grandfathered as Tier 1 capital instruments.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

With respect to Summit Community, the Basel III Capital Rules also revise the “prompt corrective action” regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under “Prompt Corrective Action.”

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Specific changes to current rules impacting our determination of risk-weighted assets include, among other things:

- Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans.
- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due.
- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%).
- Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction.

In addition, the Basel III Capital Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

The Basel III Capital Rules continue to apply the existing risk-based standard for residential mortgage loans which includes a 50% risk-weight for prudently underwritten first-lien mortgages that are not past due.

The Company and Summit Community Bank exceed all capital adequacy requirements, including applicable conservation buffers, under the Basel III Capital Rules as if such requirements were currently in effect on a fully phased-in basis.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") establishes a new regulatory scheme, which ties the level of supervisory intervention by bank regulatory authorities primarily to a depository institution's capital category. Among other things, FDICIA authorizes regulatory authorities to take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. FDICIA establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.The relevant capital measures, which reflect changes under the Basel III Capital Rules that became effective on January 1, 2015, are the total capital ratio, the CET1 capital ratio, the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) “well capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not "well capitalized"; (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%; (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes."

Community Reinvestment Act

Financial holding companies and their subsidiary banks are also subject to the provisions of the Community Reinvestment Act of 1977 ("CRA"). Under the CRA, the FRB (or other appropriate bank regulatory agency) is required, in connection with its examination of a bank, to assess such bank's record in meeting the credit needs of the communities served by that bank, including low and moderate income neighborhoods. Further, such assessment is also required of any financial holding company that has applied to (i) charter a national bank, (ii) obtain deposit insurance coverage for a newly chartered institution, (iii) establish a new branch office that will accept deposits, (iv) relocate an office, or (v) merge or consolidate with, or acquire the assets or assume the liabilities of a federally-regulated financial institution. In the case of a financial holding company applying for approval to acquire a bank or other financial holding company, the FRB will assess the record of each subsidiary of the applicant financial holding company, and such records may be the basis for denying the application or imposing conditions in connection with approval of the application. On December 8, 1993, the Federal regulators jointly announced proposed regulations to simplify enforcement of the CRA by substituting the present twelve (12) categories with three (3) assessment categories for use in calculating CRA ratings (the "December 1993 Proposal"). In response to comments received by the regulators regarding the December 1993 Proposal, the federal bank regulators issued revised CRA proposed regulations on September 26, 1994 (the "Revised CRA Proposal"). The Revised CRA Proposal, compared to the December 1993 Proposal, essentially broadens the scope of CRA performance examinations and more explicitly considers community development activities. Moreover, in 1994, the Department of Justice became more actively involved in enforcing fair lending laws.

In the most recent CRA examination by the bank regulatory authorities, Summit Community was given a "satisfactory" CRA rating.

Graham-Leach-Bliley Act of 1999

The enactment of the Graham-Leach-Bliley Act of 1999 (the "GLB Act") represents a pivotal point in the history of the financial services industry. The GLB Act swept away large parts of a regulatory framework that had its origins in the Depression Era of the 1930s. New opportunities were available for banks, other depository institutions, insurance companies and securities firms to enter into combinations that permit a single financial services organization to offer customers a more complete array of financial products and services. The GLB Act provides a new regulatory framework through the financial holding company, which has as its "umbrella regulator" the FRB. Functional regulation of the financial holding company's separately regulated subsidiaries is conducted by their primary functional regulators. The GLB Act makes a CRA rating of satisfactory or above necessary for insured depository institutions and their financial holding companies to engage in new financial activities. The GLB Act specifically gives the FRB the authority, by regulation or order, to expand the list of "financial" or "incidental" activities, but requires consultation with the U.S. Treasury Department, and gives the FRB authority to allow a financial holding company to engage in any activity that is "complementary" to a financial activity and does not "pose a substantial risk to the safety and soundness of depository institutions or the financial system generally."

Under the GLB Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect customer data from unauthorized access. We have established policies and procedures to assure our compliance with all privacy provisions of the GLB Act.

Deposit Acquisition Limitation

Under West Virginia banking law, an acquisition or merger is not permitted if the resulting depository institution or its holding company, including its affiliated depository institutions, would assume additional deposits to cause it to control deposits in the State of West Virginia in excess of twenty five percent (25%) of such total amount of all deposits held by insured depository institutions in West Virginia. This limitation may be waived by the Commissioner of Banking by showing good cause.

Consumer Laws and Regulations

In addition to the banking laws and regulations discussed above, bank subsidiaries are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. Among the more prominent of such laws and regulations are the Truth in Lending Act, the Home Mortgage Disclosure Act and Regulation C, the Electronic Funds Transfer

Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Debt Collection Act, the Right to Financial Privacy Act, and the Fair Housing Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. Bank subsidiaries must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

Dodd-Frank centralized responsibility for consumer financial protection by creating the CFPB, and giving it responsibility for implementing, examining and enforcing compliance with federal consumer protection laws. The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans, and credit cards. The CFPB's functions include investigating consumer complaints, rulemaking, supervising and examining banks' consumer transactions, and enforcing rules related to consumer financial products and services. Banks with less than $10 billion in assets, such as Summit Community, will be subject to these federal consumer financial laws, but will continue to be examined for compliance by the FDIC, its primary federal banking regulator.

On January 10, 2013, the CFPB issued final regulations implementing provisions of the Dodd-Frank Act that require all creditors to determine a consumer's ability to repay a mortgage loan before making a loan. The final rule, referred to as the Ability-to Repay (ATR)/Qualified Mortgage (QM) standards, provide that a lender making a special type of loan, known as a Qualified Mortgage, is entitled to presume that the loan complies with the ATR safe harbor requirements. The rule establishes different types of Qualified Mortgages that are generally identified as loans with restrictions on loan features, limits on fees being charged and underwriting requirements. The ATR/QM standards were effective for loan applications taken on or after January 10, 2014.

USA Patriot Act of 2001

The USA Patriot Act of 2001 and its related regulations require insured depository institutions, broker-dealers, and certain other financial institutions to have policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. The statute and its regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Federal banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants.

Pursuant to Title V of the Gramm-Leach-Bliley Act, we, like all other financial institutions, are required to:

- provide notice to our customers regarding privacy policies and practices,
- inform our customers regarding the conditions under which their non-public personal information may be disclosed to non-affiliated third parties, and
- give our customers an option to prevent certain disclosure of such information to non-affiliated third parties.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 ("SOA") addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. SOA requires our Chief Executive Officer and Chief Financial Officer each to certify that Summit's Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including requiring these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in Summit's Quarterly and Annual Reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

Furthermore, in response to the directives of the SOA, NASDAQ adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the NASDAQ Capital Market (the market on which our common stock is listed for trading). The new NASDAQ rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and of the authority, role and responsibilities of their boards of directors and, in particular, of "independent" members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

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Cybersecurity

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date, we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

Transactions with Affiliates

Federal law restricts subsidiary banks of a financial holding company from making certain extensions of credit to the parent financial holding company or to any of its subsidiaries; from investing in the holding company stock; and limits the ability of a subsidiary bank to take its parent company stock as collateral for the loans of any borrower. Additionally, federal law prohibits a financial holding company and its subsidiaries from engaging in certain tie-–in arrangements in conjunction with the extension of credit or furnishing of services.

There are various statutory and regulatory limitations, including those set forth in sections 23A and 23B of the Federal Reserve Act and the related Federal Reserve Regulation W, governing the extent to which the bank will be able to purchase assets from or securities of or otherwise finance or transfer funds to us or our non-banking affiliates. Among other restrictions, such transactions between the bank and any one affiliate (including Summit) generally will be limited to ten percent (10%) of the bank's capital and surplus, and transactions between the bank and all affiliates will be limited to twenty percent (20%) of the bank's capital and surplus. Furthermore, loans and extensions of credit are required to be secured in specified amounts and are required to be on terms and conditions consistent with safe and sound banking practices.

In addition, any transaction by a bank with an affiliate and any sale of assets or provisions of services to an affiliate generally must be on terms that are substantially the same, or at least as favorable, to the bank as those prevailing at the time for comparable transactions with non-affiliated companies.

Incentive Compensation

The Federal Reserve Board reviews, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as Summit, that are not “large, complex banking organizations.” These reviews are tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of this supervisory initiative will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to

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materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

In April 2011, the Federal Reserve Board, other federal banking agencies and the SEC jointly published proposed rulemaking designed to implement provisions of the Dodd-Frank Act prohibiting incentive compensation arrangements that would encourage inappropriate risk taking at a covered institution, which includes a bank or bank holding company with $1 billion or more of assets, such as Summit. The proposed rule (i) prohibits incentive-based compensation arrangements that encourage executive officers, employees, directors or principal shareholders to expose the institution to inappropriate risks by providing excessive compensation (based on the standards for excessive compensation adopted pursuant to the FDIA) and (ii) prohibits incentive-based compensation arrangements for executive officers, employees, directors or principal shareholders that could lead to a material financial loss for the institution. The proposed rule requires covered institutions to establish policies and procedures for monitoring and evaluating their compensation practices. The comment period ended in May 2011. Although final rules have not been adopted as of February 2016, officials from the Federal Reserve have recently indicated that the U.S. banking regulators are in the process of preparing for public comment a new rule on incentive compensation. If these or other regulations are adopted in a form similar to that initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives.

The scope and content of the U.S. banking regulators' policies on incentive compensation are continuing to develop. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will adversely affect the ability of Summit and its subsidiaries to hire, retain and motivate their key employees.

Competition

We engage in highly competitive activities. Each activity and market served involves competition with other banks and savings institutions, as well as with non-banking and non-financial enterprises that offer financial products and services that compete directly with our products and services. We actively compete with other banks, mortgage companies and other financial service companies in our efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

Of particular note, banking laws limit the total amount we can lend to any one borrower generally to 15 percent of Summit Community's Tier 1 capital plus its allowance for loan losses. Summit Community evaluated the risks and rewards of lending up to this legal lending limit, and established a self-imposed lending limit equal to 75 percent of its legal lending limit. Accordingly, institutions larger than Summit Community have a natural competitive advantage to serve the loan needs of larger clients as their legal lending limits are proportionally greater than ours.

In addition to competing with other banks and mortgage companies, we compete with other financial institutions engaged in the business of making loans or accepting deposits, such as savings and loan associations, credit unions, industrial loan associations, insurance companies, small loan companies, finance companies, real estate investment trusts, certain governmental agencies, credit card organizations and other enterprises. In addition, competition for money market accounts from securities brokers has also intensified. Additional competition for deposits comes from government and private issues of debt obligations and other investment alternatives for depositors, such as money market funds. We take an aggressive competitive posture, and intend to continue vigorously competing for market share within our service areas by offering competitive rates and terms on both loans and deposits.

Employees

At February 25, 2016, we employed 231 full-time equivalent employees.

Available Information

Our Internet website address is www.summitfgi.com, and our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and amendments to such filed reports with the SEC are accessible through this website free of charge as soon as reasonably practicable after we electronically file such reports with the SEC. The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filing with the SEC.

These reports are also available at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may read and copy any materials that we file with the SEC at the Public Reference Room on official business days during the hours

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of 10:00 a.m. to 3:00 p.m. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Statistical Information

The information noted below is provided pursuant to Guide 3 – Statistical Disclosure by Bank Holding Companies.

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Item 1A. Risk Factors

We, like other financial holding companies, are subject to a number of risks that may adversely affect our financial condition or results of operation, many of which are outside of our direct control, though efforts are made to manage those risks while optimizing returns. Among the risks assumed are: (i) credit risk, which is the risk of loss due to loan clients or other counterparties not being able to meet their financial obligations under agreed upon terms, (ii) market risk, which is the risk of loss due to changes in the market value of assets and liabilities due to changes in market interest rates, equity prices, and credit spreads, (iii) liquidity risk, which is the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, investor and customer perception of financial strength, and events unrelated to the Company such as war, terrorism, or financial institution market specific issues, and (iv) operational risk, which is the risk of loss due to human error, inadequate or failed internal systems and controls, violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards, and external influences such as market conditions, fraudulent activities, disasters, and security risks.

In addition to the other information included or incorporated by reference into this report, readers should carefully consider that the following important factors, among others, could materially impact our business, future results of operations, and future cash flows.

RISKS RELATING TO THE ECONOMIC ENVIRONMENT

Our business may be adversely affected by conditions in financial markets and economic conditions generally.

Our business is concentrated in West Virginia and the Shenandoah Valley and Northern region of Virginia. As a result, our financial condition, results of operations and cash flows are subject to changes if there are changes in the economic conditions in these areas. A prolonged period of economic recession or other adverse economic conditions in these areas could have a negative impact on Summit. A significant decline in general economic conditions nationally, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets, declines in the housing market, a tightening credit environment or other factors could impact these local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

Business activity across a wide range of industries and regions in the U.S. remains greatly reduced compared to that prior to the 2008 economic downturn. Certain sectors continue to recover and significant numbers of individuals are underemployed or have even given up seeking employment. Financial stress on borrowers as a result of an uncertain economic environment could have an adverse effect on our borrowers or customers, which could adversely affect our financial condition and results of operations. Deterioration in local economic conditions, particularly within our geographic regions and markets, could drive losses beyond that which is provided for in our allowance for loan losses. We may also face the following risks in connection with these events:

- Economic conditions that negatively affect real estate values and the job market have resulted, and may continue to result, in deterioration in credit quality of our loan portfolios, and such deterioration in credit quality has had, and could continue to have, a negative impact on our business.
- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.
- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage and underwrite our customers become less predictive of future charge-offs.
- We expect to face increased regulation of our industry, and compliance with such regulation may increase our costs, limit our ability to pursue business opportunities and increase compliance challenges.

As the above conditions or similar ones continue to exist or worsen, we could experience continuing or increased adverse effects on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, or other institutional firms. Defaults by financial services institutions, and even rumors or questions about a financial institution or the financial services industry in general, have led to market wide liquidity problems and could lead to losses or defaults by us or other institutions. Any such losses could adversely affect our financial condition or results of operations.

RISKS RELATING TO OUR BUSINESS

We are subject to extensive government regulation and supervision.

The Company and Summit Community are subject to extensive federal and state regulation and supervision, which vests a significant amount of discretion in the various regulatory authorities. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not security holders. These regulations and supervisory guidance affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or regulatory policies or supervisory guidance, including changes in interpretation or implementation of statutes, regulations, policies or supervisory guidance, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by Federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputation damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect to compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. Any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

See the section captioned "Supervision and Regulation" included in Item 1. Business on page 1.

We may become subject to additional regulatory restrictions in the event that our regulatory capital levels decline.

Although the Bank is qualified as "well capitalized" under the regulatory framework for prompt corrective action as of December 31, 2015, there is no guarantee that we will not have a decline in our capital category in the future. In the event of such a capital category decline, we would be subject to increased regulatory restrictions that could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects.

If a bank is classified as undercapitalized, the bank is required to submit a capital restoration plan to the FDIC. Pursuant to FDICIA, an undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the FDIC of a capital restoration plan for the bank. Furthermore, if a state non-member bank is classified as undercapitalized, the FDIC may take certain actions to correct the capital position of the bank; if a bank is classified as significantly undercapitalized or critically undercapitalized, the FDIC would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital; improvements in management; limits on interest rates paid; prohibitions on transactions with affiliates; termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership within ninety (90) days, unless the Federal Reserve determines that other action would better achieve the purposes of FDICIA regarding prompt corrective action with respect to undercapitalized banks.

Under FDICIA, banks may be restricted in their ability to accept brokered deposits, depending on their capital classification. "Well capitalized" banks are permitted to accept brokered deposits, but all banks that are not well capitalized could be restricted from accepting such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. These restrictions could materially and adversely affect our ability to access lower costs funds and thereby decrease our future earnings capacity.

Our financial flexibility could be severely constrained if we are unable to renew our wholesale funding or if adequate financing is not available in the future at acceptable rates of interest. We may not have sufficient liquidity to continue to fund new loan originations, and we may need to liquidate loans or other assets unexpectedly in order to repay obligations as they mature. Our inability to obtain regulatory consent to accept or renew brokered deposits could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects and our ability to continue as a going concern.

Finally, the capital classification of a bank affects the frequency of examinations of the bank, the deposit insurance premiums paid by such bank, and the ability of the bank to engage in certain activities, all of which could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects. Under FDICIA, the FDIC is required to conduct a full-scope, on-site examination of every bank at least once every twelve (12) months. An exception to this rule is made, however, that provides that banks (i) with assets of less than $100.0 million, (ii) that are categorized as "well capitalized," (iii) that were found to be well managed and whose composite rating was outstanding and (iv) that have not been subject to a change in control during the last twelve (12) months, need only be examined by the FDIC once every eighteen (18) months.

Our decisions regarding credit risk could be inaccurate, and our allowance for loan losses may be inadequate, which could materially and adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

Our loan portfolio subjects us to credit risk. Inherent risks in lending also include fluctuations in collateral values and economic downturns. Making loans is an essential element of our business, and there is a risk that our loans will not be repaid.

We attempt to maintain an appropriate allowance for loan losses to provide for estimated probable credit losses inherent in our loan portfolio. As of December 31, 2015, our allowance for loan losses totaled $11.5 million, which represents approximately 1.05% of our total loans. There is no precise method of predicting loan losses, and therefore, we always face the risk that charge-offs in future periods will exceed our allowance for loan losses and that we would need to make additional provisions to our allowance for loan losses.

Our methodology for the determination of the adequacy of the allowance for loan losses for impaired loans is based on classifications of loans into various categories and the application of generally accepted accounting principles in the United States. For non-classified loans, the estimated allowance is based on historical loss experiences as adjusted for changes in trends and conditions on at least an annual basis. In addition, on a quarterly basis, the estimated allowance for non-classified loans is adjusted for the probable effect that current environmental factors could have on the historical loss factors currently in use. While our allowance for loan losses is established in different portfolio components, we maintain an allowance that we believe is sufficient to absorb all estimated probable credit losses inherent in our portfolio.

In addition, the FDIC as well as the West Virginia Division of Financial Institutions review our allowance for loan and lease losses and may require us to establish additional reserves. Additions to the allowance for loan and lease losses will result in a decrease in our net earnings and capital and could hinder our ability to grow our assets.

We do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely affected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

We may elect or be compelled to seek additional capital in the future, but capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. In addition, we may elect to raise additional capital to support our business or to finance acquisitions, if any, or we may otherwise elect to raise additional capital. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise additional capital, if needed or on terms acceptable to us. If we cannot raise additional capital when needed, it may have a material adverse effect on our financial condition, results of operations and prospects.

We rely on funding sources to meet our liquidity needs, such as brokered deposits and FHLB borrowings, which are generally more sensitive to changes in interest rates and can be adversely affected by general economic conditions.

We have frequently utilized, as a source of funds, certificates of deposit obtained through third parties that solicit funds from their customers for deposit with us, or brokered deposits. Brokered deposits, when compared to retail deposits attracted through a branch network, are generally more sensitive to changes in interest rates and volatility in the capital markets and could reduce our net interest spread and net interest margin. In addition, brokered deposit funding sources may be more sensitive to significant changes in our financial condition. As of December 31, 2015, brokered deposits totaled $126.5 million, or approximately 11.9% of our total deposits, compared to brokered deposits in the amount of $146.9 million or approximately

13.8% of our total deposits at December 31, 2014. As of December 31, 2015, approximately $29.0 million in brokered deposits, or approximately 22.9% of our total brokered deposits, mature within one year. Our ability to continue to acquire brokered deposits is subject to our ability to price these deposits at competitive levels, which may increase our funding costs and the confidence of the market. In addition, if our capital ratios fall below the levels necessary to be considered "well capitalized" under current regulatory guidelines, we could be restricted from using brokered deposits as a funding source.

We also have borrowings with the Federal Home Loan Bank of Pittsburgh, or the FHLB. As of December 31, 2015, our FHLB borrowings maturing within one year totaled $168.0 million. If we were unable to borrow from the FHLB in the future, we may be required to seek higher cost funding sources, which could materially and adversely affect our net interest income.

One aspect of our liquidity management process is establishing contingent liquidity funding plans under various scenarios in order to prepare for unexpected liquidity shortages or events. The following represents three "stressed" liquidity circumstances and our related contingency plans with respect to each.

Scenario 1 – Summit Community's capital status becomes less than "well capitalized". Banks which are less than "well capitalized" in accordance with regulatory capital guidelines are prohibited from issuing new brokered deposits without first obtaining a waiver from the FDIC to do so. In the event Summit Community's capital status were to fall below well capitalized and was not successful in obtaining the FDIC's waiver to issue new brokered deposits, Summit Community:

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than $50 million.
- Presently has $629 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company.
- Would generally have no more than $100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

Scenario 2 – Summit Community's credit quality deteriorates such that the FHLB restricts further advances. If in the event that the Bank's credit quality deteriorated to the point that further advances under its line with the FHLB were restricted, Summit Community:

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances.
- Would still have available current liquid funding sources secured by unemcumbered loans and securities totaling $281 million aside from its FHLB line, which would result in a funding source of approximately $221 million.

Scenario 3 – A competitive financial institution offers a retail deposit program at interest rates significantly above current market rates in Summit Community's market areas. If a competitive financial institution offered a retail deposit program at rates well in excess of current market rates in Summit Community's market area, the Bank:

- Presently has $629 million in available sources of liquid funds which could be drawn upon immediately to fund any "net run off" of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

We operate in a very competitive industry and market.

We face aggressive competition not only from banks, but also from other financial services companies, including finance companies and credit unions, and, to a limited degree, from other providers of financial services, such as money market mutual funds, brokerage firms, and consumer finance companies. A number of competitors in our market areas are larger than we are and have substantially greater access to capital and other resources, as well as larger lending limits and branch systems, and offer a wider array of banking services. Many of our non-bank competitors are not subject to the same extensive regulations

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that govern us. As a result, these non-bank competitors have advantages over us in providing certain services. Our profitability depends upon our ability to attract loans and deposits. There is a risk that aggressive competition could result in our controlling a smaller share of our markets. A decline in market share could adversely affect our results of operations and financial condition.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on those properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Changes in interest rates could negatively impact our future earnings.

Changes in interest rates could reduce income and cash flow. Our income and cash flow depend primarily on the difference between the interest earned on loans and investment securities, and the interest paid on deposits and other borrowings. Interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the FRB. Changes in monetary policy, including changes in interest rates, will influence loan originations, purchases of investments, volumes of deposits, and rates received on loans and investment securities and paid on deposits. Our results of operations may be adversely affected by increases or decreases in interest rates or by the shape of the yield curve.

The repeal of Federal prohibitions on payment of interest on demand deposits could increase our interest expense as interest rates rise.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act beginning on July 21, 2011. As a result, some financial institutions have commenced offering interest on demand deposits to compete for customers. We do not yet know what interest rates other institutions may offer as market interest rates begin to increase. Our interest expense will increase and our net interest margin will decrease if we begin offering interest on demand deposits to attract additional customers or maintain current customers, which could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to significant government regulation.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the West Virginia Division of Financial Institutions, the FRB and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law.

Future legislation and government policy could adversely affect the banking industry as a whole, including our results of operations. New legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, assess fees, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

We rely heavily on our management team, and the unexpected loss of key officers could adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

Our success has been and will continue to be greatly influenced by our ability to retain the services of existing senior management and, as we expand, to attract and retain qualified additional senior and middle management. Our senior executive officers have been instrumental in the development and management of our business. The loss of the services of any of our senior executive officers could have an adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects. We have not established a detailed management succession plan. Accordingly, should we lose the services of any of our senior executive officers, our Board of Directors may have to search outside of Summit Financial Group for a qualified permanent replacement. This search may be prolonged, and we cannot assure you that we will be able to locate and hire a qualified

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replacement. If any of our senior executive officers leaves his or her respective position, our business, financial condition, results of operations, cash flows and/or future prospects may suffer.

Our information systems may experience failure, interruption or breach in security.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. Any failure, interruption or breach in security of these systems could result in significant disruption to our operations. Information security breaches and cybersecurity-related incidents may include, but are not limited to, attempts to access information, including customer and company information, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. Our technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. The risk of a security breach or disruption, particularly through cyber attack or cyber intrusion, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

Our business requires the collection and retention of large volumes of customer data, including personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal company data such as personally identifiable information about our employees and information relating to our operations. The integrity and protection of that customer and company data is important to us. Our collection of such customer and company data is subject to extensive regulation and oversight.

Our customers and employees have been, and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, bank account information or other personal information or to introduce viruses or other malware through "Trojan horse" programs to our information systems and/or our customers' computers. Though we endeavor to mitigate these threats through product improvements, use of encryption and authentication technology and customer and employee education, such cyber attacks against us or our merchants and our third party service providers remain a serious issue. The pervasiveness of cybersecurity incidents in general and the risks of cyber crime are complex and continue to evolve. More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. While we maintain specific “cyber” insurance coverage, which would apply in the event of various breach scenarios, the amount of coverage may not be adequate in any particular case. Furthermore, because cyber threat scenarios are inherently difficult to predict and can take many forms, some breaches may not be covered under our cyber insurance coverage.

A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third party vendors, including as a result of cyber attacks, could (i) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; (ii) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (iii) result in a violation of applicable privacy, data breach and other

laws, subjecting us to additional regulatory scrutiny and expose the us to civil litigation, governmental fines and possible financial liability; (iv) require significant management attention and resources to remedy the damages that result; or (v) harm our reputation or cause a decrease in the number of customers that choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.
The negative economic effects caused by terrorist attacks, including cyber attacks, potential attacks and other destabilizing events, would likely contribute to the deterioration of the quality of our loan portfolio and could reduce our customer base, level of deposits and demand for our financial products, such as loans.

High inflation, natural disasters, acts of terrorism, including cyber attacks, an escalation of hostilities or other international or domestic occurrences and other factors could have a negative impact on the economy of the Mid-Atlantic regions in which we operate. An additional economic downturn in our markets would likely contribute to the deterioration of the quality of our loan portfolio by impacting the ability of our customers to repay loans, the value of the collateral securing loans, and may reduce the level of deposits in our bank and the stability of our deposit funding sources. An additional economic downturn could also have a significant impact on the demand for our products and services. The cumulative effect of these matters on our results of operations and financial condition could be adverse and material.

We are dependent upon third parties for certain information system, data management and processing services and to provide key components of our business infrastructure.

We outsource certain information system and data management and processing functions to third party providers. These third party service providers are sources of operational and informational security risk to us, including risks associated with operational errors, information system interruptions or breaches, and unauthorized disclosures of sensitive or confidential client or customer information. If third party service providers encounter any of these issues, or if we have difficulty communicating with them, we could be exposed to disruption of operations, loss of service or connectivity to customers, reputational damage, and litigation risk that could have a material adverse effect on our results of operations or our business.

Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third party vendors carefully, we do not control their actions.

These services must be available on a continuous and timely basis and be in compliance with any regulatory requirements. Failure to do so could substantially harm our business.

We often purchase services from vendors under agreements that typically can be terminated on a periodic basis. There can be no assurance, however, that vendors will be able to meet their obligations under these agreements or that we will be able to compel them to do so. Risks of relying on vendors include the following:

- If an existing agreement expires or a certain service is discontinued by a vendor, then we may not be able to continue to offer our customers the same breadth of products, and our operating results would likely suffer unless we are able to find an alternate supply of a similar service.
- Agreements we may negotiate in the future may commit us to certain minimum spending obligations. It is possible that we will not be able to create the market demand to meet such obligations.
- If market demand for our products increases suddenly, our current vendors might not be able to fulfill our commercial needs, which would require us to seek new arrangements or new sources of supply and may result in substantial delays in meeting market demand.
- We may not be able to control or adequately monitor the quality of services we receive from our vendors. Poor quality services could damage our reputation with our customers.

Potential problems with vendors such as those discussed above could have a significant adverse effect on our business, lead to higher costs and damage our reputation with our customers and, in turn, have a material adverse effect on our financial condition and results of operations.

Changes in accounting standards could impact reported earnings.

The accounting standard setting bodies, including the Financial Accounting Standards Board and other regulatory bodies, periodically change the financial accounting and reporting standards affecting the preparation of financial statements. These changes are not within our control and could materially impact our financial statements.

Our business is dependent on technology, and our inability to invest in technological improvements may adversely affect our results of operations, financial condition and cash flows.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success depends in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as create additional efficiencies in its operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers, which may negatively affect our results of operations, financial condition and cash flows.

Our potential inability to integrate companies we may acquire in the future could have a negative effect on our expenses and results of operations.

On occasion, we may engage in a strategic acquisition when we believe there is an opportunity to strengthen and expand our business. To fully benefit from such acquisition, however, we must integrate the administrative, financial, sales, lending, collections and marketing functions of the acquired company. If we are unable to successfully integrate an acquired company, we may not realize the benefits of the acquisition, and our financial results may be negatively affected. A completed acquisition may adversely affect our financial condition and results of operations, including our capital requirements and the accounting treatment of the acquisition. Completed acquisitions may also lead to significant unexpected liabilities after the consummation of these acquisitions.

RISKS RELATING TO AN INVESTMENT IN OUR SECURITIES

Our ability to pay dividends is limited.

We are a separate and distinct legal entity from our subsidiaries. We receive substantially all of our revenue from dividends from our subsidiary bank, Summit Community. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Summit Community may pay to Summit. Also, Summit's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event Summit Community is unable to pay dividends to us, we may not be able to service debt, pay obligations or pay dividends on our common stock. The inability to receive dividends from Summit Community could have a material adverse effect on our business, financial condition and results of operations.

The market price for shares of our common stock may fluctuate.

The market price of our common stock could be subject to significant fluctuations due to a change in sentiment in the market regarding our operations or business prospects. Such risks may include:

- Operating results that vary from the expectations of management, securities analysts and investors;
- Developments in our business or in the financial sector generally;
- Regulatory changes affecting our industry generally or our businesses and operations;
- Regulatory changes affecting our industry generally or our businesses and operations;
- Announcements of strategic developments, acquisitions and other material events by us or our competitors;
- Changes in the credit, mortgage and real estate markets, including the markets for mortgage-related securities;
- Changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stocks, commodity, credit or asset valuations or volatility;
- Changes in securities analysts' estimates of financial performance;
- Volatility of stock market prices and volumes;
- Rumors or erroneous information;
- Changes in market valuations of similar companies;
- Changes in interest rates;
- New developments in the banking industry;
- Variations in our quarterly or annual operating results;
- New litigation or changes in existing litigation; and
- Regulatory actions

Our executive officers and directors own shares of our common stock, allowing management to have an impact on our corporate affairs.

As of February 25, 2016 our executive officers and directors beneficially own 20.04% (computed in accordance with Exchange Act Rule 13d-3) of the outstanding shares of our common stock. Accordingly, these executive officers and directors will be able

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to impact the outcome of all matters required to be submitted to our shareholders for approval, including decisions relating to the election of directors, the determination of our day-to-day corporate and management policies and other significant corporate transactions.

There may be future sales of additional common stock or preferred stock or other dilution of our equity, which may adversely affect the market price of our common stock.

Our board of directors is authorized to cause us to issue additional classes or series of preferred shares without any action on the part of the shareholders. The board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred shares that may be issued, including voting rights, dividend rights and preferences over the common stock with respect to dividends or upon the liquidation, dissolution or winding-up of our business and other terms. If we issue preferred shares in the future that have a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of the common stock could be adversely affected.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock or preferred stock or similar securities in the market or the perception that such sales could occur.

Holders of our junior subordinated debentures have rights that are senior to those of our shareholders.

We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third-party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures of these unconsolidated statutory trusts totaled approximately $19.6 million at December 31, 2015 and 2014.

Distributions on the capital securities issued by the trusts are payable quarterly, at the variable interest rates specified in those certain securities. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures.

Payments of the principal and interest on the trust preferred securities of the statutory trusts are conditionally guaranteed by us. The junior subordinated debentures are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on the junior subordinated debentures (and the related trust preferred securities) for up to five (5) years, during which time no dividends may be paid on our common stock. In 2015, our total interest payments on these junior subordinated debentures approximated $521,000. Based on current rates, our quarterly interest payment obligation on our junior subordinated debentures is approximately $137,000.

The capital securities held by our three trust subsidiaries qualify as Tier 1 capital under FRB guidelines. In accordance with these guidelines, trust preferred securities generally are limited to twenty-five percent (25%) of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital.

Provisions of our amended and restated articles of incorporation could delay or prevent a takeover of us by a third party.

Our amended and restated articles of incorporation could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or could otherwise adversely affect the price of our common stock. For example, our amended and restated articles of incorporation contain advance notice requirements for nominations for election to our Board of Directors. We also have a staggered board of directors, which means that only one-third (1/3) of our Board of Directors can be replaced by shareholders at any annual meeting.

Our stock price can be volatile.

Stock price volatility may make it more difficult for our shareholders to resell their common stock when they want and at prices they find attractive. Our stock price can fluctuate significantly in response to a variety of factors, including, among other things:

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- Actual or anticipated negative variations in quarterly results of operations;
- Negative recommendations by securities analysts;
- Poor operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to negative trends, concerns, and other issues in the financial services industry or the economy in general;
- Negative perceptions in the marketplace regarding us and/or our competitors;
- New technology used, or services offered, by competitors;
- Adverse changes in interest rates or a lending environment with prolonged low interest rates;
- Adverse changes in the real estate market;
- Negative economic news;
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- Adverse changes in government regulations; and
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease, regardless of operating results.

Your shares are not an insured deposit.

Your investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC or any other government agency. Your investment is subject to investment risk, and you must be capable of affording the loss of your entire investment.

OTHER RISKS

Additional factors could have a negative effect on our financial performance and the value of our common stock. Some of these factors are general economic and financial market conditions, continuing consolidation in the financial services industry, new litigation or changes in existing litigation, regulatory actions, and losses.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal executive office is located at 300 North Main Street, Moorefield, West Virginia, in a building owned by Summit Community. Summit Community's headquarters and branch locations occupy offices which are either owned or operated under lease arrangements. At December 31, 2015, Summit Community operated 15 banking offices. Summit Insurance Services, LLC operates out of the Moorefield, West Virginia, and Leesburg, Virginia, offices of Summit Community, and also leases a location in Leesburg, Virginia.

	Number of Offices		
Office Location	Owned	Leased	Total
Summit Community Bank			
Moorefield, West Virginia	1	—	1
Mathias, West Virginia	1	—	1
Franklin, West Virginia	1	—	1
Petersburg, West Virginia	1	—	1
Charleston, West Virginia	2	—	2
Rainelle, West Virginia	1	—	1
Rupert, West Virginia	1	—	1
Winchester, Virginia	1	1	2
Leesburg, Virginia	1	—	1
Harrisonburg, Virginia	1	1	2
Warrenton, Virginia	—	1	1
Martinsburg, West Virginia	1	—	1
Summit Insurance Services, LLC			
Leesburg, Virginia	—	1	1

We believe that the premises occupied by us and our subsidiaries generally are well located and suitably equipped to serve as financial services facilities. See Notes 7 and 8 of our consolidated financial statements on page 74.

Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Litigation" in Note 15 of our consolidated financial statements beginning on page 83.

Item 4. Mine Safety Disclosures

Not applicable.

PART II.

Item 5. Market for Registrant's Common Equity Related Stockholder Matters and Issuer Purchases of Equity

Common Stock Dividend and Market Price Information: Our stock trades on the NASDAQ Capital Market under the symbol "SMMF." The following table presents cash dividends paid per share and information regarding bid prices per share of Summit's common stock for the periods indicated. The bid prices presented are based on information reported by NASDAQ and may reflect inter-dealer prices, without retail mark-up, mark-down or commission, and not represent actual transactions.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2015				
Dividends paid	$0.08	$0.08	$0.08	$0.08
High Bid	12.87	13.09	12.79	12.00
Low Bid	10.80	11.15	11.27	11.03
2014				
Dividends paid	$—	$—	$—	$—
High Bid	11.00	11.23	10.98	12.70
Low Bid	8.89	9.75	9.17	9.61

The payment of dividends is subject to the restrictions set forth in the West Virginia Business Corporation Act and the limitations imposed by the FRB. Payment of dividends by Summit is primarily dependent upon receipt of dividends from Summit Community. Payment of dividends by Summit Community is regulated by the Federal Reserve System and generally, the prior approval of the FRB is required if the total dividends declared by a state member bank in any calendar year exceeds its net profits, as defined, for that year combined with its retained net profits for the preceding two years. Additionally, prior approval of the FRB is required when a state member bank has deficit retained earnings but has sufficient current year's net income, as defined, plus the retained net profits of the two preceding years. The FRB may prohibit dividends if it deems the payment to be an unsafe or unsound banking practice. The FRB has issued guidelines for dividend payments by state member banks emphasizing that proper dividend size depends on the bank's earnings and capital. See Note 18 of our consolidated financial statements on page 85.

As of February 24, 2016, there were approximately 1,186 shareholders of record of Summit's common stock.

Purchases of Summit Equity Securities: We have an Employee Stock Ownership Plan ("ESOP"), which enables eligible employees to acquire shares of our common stock. The cost of the ESOP is borne by us through annual contributions to an Employee Stock Ownership Trust in amounts determined by the Board of Directors.

The following table sets forth certain information regarding Summit's purchase of its common stock under Summit's ESOP for the quarter ended December 31, 2015.

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1, 2015 - October 31, 2015	—	$—	—	—
November 1, 2015 - November 30, 2015	—	—	—	—
December 1, 2015 - December 31, 2015	—	—	—	—

(a) Shares purchased under the Employee Stock Ownership Plan.

Performance Graph: Set forth below is a line graph comparing the cumulative total return of Summit's common stock assuming reinvestment of dividends, with that of the NASDAQ Composite Index ("NASDAQ Composite") and a peer group for the five-year period ending December 31, 2015. The "Summit Peer Group" consists of fifteen (excluding Summit) publicly-traded bank holding companies headquartered in West Virginia and Virgina having total assets between $1 billion and $5 billion.

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The cumulative total shareholder return assumes a $100 investment on December 31, 2010 in the common stock of Summit and each index and the cumulative return is measured as of each subsequent fiscal year-end. There is no assurance that Summit's common stock performance will continue in the future with the same or similar trends as depicted in the graph.

	For the Year Ended					
Index	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Summit Financial Group, Inc.	100.00	67.41	119.51	244.69	293.83	301.53
NASDAQ Composite	100.00	99.21	116.82	163.75	188.03	201.40
Summit Peer Group	100.00	81.07	102.33	128.58	134.12	154.00

The Stock Performance Graph and related information shall not be deemed “soliciting material” or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that Summit specifically incorporates it by reference into such filing.

Item 6. Selected Financial Data

The following consolidated selected financial data is derived from our audited financial statements as of and for the five (5) years ended December 31, 2015. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes contained elsewhere in this report.

	For the Year Ended (unless otherwise noted)				
Dollars in thousands, except per share amounts	2015	2014	2013	2012	2011
Summary of Operations					
Interest income	$58,883	$57,626	$57,280	$63,884	$71,047
Interest expense	12,867	15,241	18,477	24,064	31,203
Net interest income	46,016	42,385	38,803	39,820	39,844
Provision for loan losses	1,250	2,250	4,500	8,500	10,000
Net interest income after provision for loan losses	44,766	40,135	34,303	31,320	29,844
Noninterest income	11,861	11,223	11,209	12,879	11,906
Noninterest expense	33,632	35,324	34,756	37,267	36,641
Income (loss) before income taxes	22,995	16,034	10,756	6,932	5,109
Income tax expense (benefit)	6,893	4,678	2,688	1,219	1,035
Net income (loss)	16,102	11,356	8,068	5,713	4,074
Dividends on preferred shares	—	771	775	777	371
Net income (loss) applicable to common shares	$16,102	$10,585	$7,293	$4,936	$3,703
Balance Sheet Data (at year end)					
Assets	$1,492,429	$1,443,568	$1,386,227	$1,387,104	$1,450,121
Securities available for sale	280,792	282,834	288,780	281,539	286,599
Loans	1,079,331	1,019,842	937,070	937,168	965,516
Deposits	1,066,709	1,061,314	1,003,812	1,027,125	1,016,500
Short-term borrowings	171,394	123,633	62,769	3,958	15,956
Long-term borrowings	75,581	77,490	163,516	203,268	270,254
Shareholders' equity	143,744	131,644	111,072	108,555	102,566
Credit Quality					
Net loan charge-offs	$945	$3,742	$9,774	$8,279	$9,512
Nonperforming assets	41,340	50,244	72,346	93,954	116,641
Allowance for loan losses	11,472	11,167	12,659	17,933	17,712
Per Share Data					
Earnings per share					
Basic earnings	$1.56	$1.40	$0.98	$0.66	$0.50
Diluted earnings	1.50	1.17	0.84	0.60	0.49
Book value per common share (at year end) (A)	13.48	12.60	11.55	11.31	10.68
Tangible book value per common share (at year end) (A)	12.78	11.86	10.72	10.44	9.78
Cash dividends	$0.32	—	—	—	—
Performance Ratios					
Return on average equity	11.62 %	9.54 %	7.38 %	5.36 %	4.32 %
Return on average tangible equity	12.29 %	10.22 %	7.98 %	5.82 %	4.77 %

Return on average assets	1.10	%	0.80	%	0.58	%	0.40	%	0.28	%
Equity to assets	9.6	%	9.1	%	8.0	%	7.8	%	7.1	%
Tangible equity to tangible assets	9.2	%	8.6	%	7.5	%	7.3	%	6.5	%
Tangible common equity to tangible assets	9.2	%	8.0	%	6.8	%	6.6	%	5.9	%

(A)- Assumes conversion of convertible preferred stock

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

FORWARD LOOKING STATEMENTS

This annual report contains comments or information that constitute forward looking statements (within the meaning of the Private Securities Litigation Act of 1995) that are based on current expectations that involve a number of risks and uncertainties. Words such as “expects”, “anticipates”, “believes”, “estimates” and other similar expressions or future or conditional verbs such as “will”, “should”, “would” and “could” are intended to identify such forward-looking statements. The Private Securities Litigation Act of 1995 indicates that the disclosure of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by us. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in those forward-looking statements.

Although we believe the expectations reflected in such forward looking statements are reasonable, actual results may differ materially. Factors that might cause such a difference include changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; the impact of technological advances; the outcomes of contingencies; trends in customer behavior as well as their ability to repay loans; and changes in the national and local economy.

DESCRIPTION OF BUSINESS

We are a $1.49 billion community-based financial services company providing a full range of banking and other financial services to individuals and businesses through our two operating segments: community banking and insurance. Our community bank, Summit Community Bank, has a total of 15 banking offices located in West Virginia and Virginia. In addition, we also operate an insurance agency, Summit Insurance Services, LLC, with an office in Moorefield, West Virginia which offers both commercial and personal lines of insurance and two offices in Leesburg, Virginia, primarily specializing in group health, life and disability benefit plans. See Note 19 of the accompanying consolidated financial statements for our segment information. Summit Financial Group, Inc. employs approximately 231 full time equivalent employees.

OVERVIEW

Our primary source of income is net interest income from loans and deposits. Business volumes tend to be influenced by the overall economic factors including market interest rates, business spending, and consumer confidence, as well as competitive conditions within the marketplace.

Key Items in 2015

- 2015 was our most profitable year in our history, with net income of $16.10 million compared to $10.59 million in 2014.
- Net interest margin improved 11 basis points in 2015, principally due to a 20 basis point reduction in our cost of funds, resulting primarily from repayment of subordinated debentures funded with lower-cost short term borrowings.
- Revenues increased $4.3 million, or 8.0 percent during 2015.
- We achieved loan growth of 5.8%, or $59.8 million during 2015.
- Nonperforming assets declined to their lowest level since 2008, representing 2.77 percent of total assets at year end 2015 compared to 3.48 percent at the prior year end.
- During 2015, provisions for loan losses declined by $1.0 million while charges to write down foreclosed properties to their fair values declined $1.4 million.
- We resumed paying cash dividends on our common stock in 2015 totaling $0.32 per share.

OUTLOOK

The year just concluded marked a significant milestone towards Summit's goal of being a consistent, high-performing community banking institution. Our improved earnings performance, increased return on assets and equity, growing loan portfolio, increasing revenues, improved net interest margin, strengthened capital, reinstated dividends, and continuing reductions in the portfolio of problem assets, all serve as evidence towards achievement of this goal. Looking forward, while we will be challenged by a variety of economic uncertainties, management anticipates continuing positive earnings trends, as a result of a growing balance sheet, higher revenues, and lower costs of problem assets.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the financial services industry. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

Our most significant accounting policies are presented in the notes to the accompanying consolidated financial statements. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, we have identified the determination of the allowance for loan losses, the valuation of goodwill, fair value measurements and deferred tax assets to be the accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Allowance for Loan Losses: The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 6 to the accompanying consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of this financial review.

Goodwill: Goodwill is subject to an analysis by reporting unit at least annually to determine whether write-downs of the recorded balances are necessary. Initially, an assessment of qualitative factors (Step 0) is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test is unnecessary. However, if we conclude otherwise, then we are required to perform the first step (Step 1) of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. Step 2 of impairment testing, which is necessary only if the reporting unit does not pass Step 1, compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

Community Banking – During third quarter 2015, we performed the Step 0 assessment of our goodwill of our community banking reporting unit and determined that it was not more likely than not that the fair value was less than its carrying value. In performing the qualitative Step 0 assessments, we considered certain events and circumstances such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value is less than its carrying amount. No indicators of impairment were noted as of September 30, 2015.

Insurance Services – During third quarter 2015, we performed the Step 0 assessment of our goodwill of our insurance services reporting unit. We considered certain events and circumstances specific to the reporting unit, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of our insurance services reporting unit is less than its carrying value and deemed it necessary to perform the further 2-step impairment test. We performed an internal valuation utilizing the income approach to determine the fair value of our insurance services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 2%, and a discount rate of 10.0% was applied to the insurance services unit's estimated future cash flows. We did not fail this Step 1 test as of September 30, 2015, therefore Step 2 testing was not necessary.

We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Note 9 of the accompanying consolidated financial statements for further discussion of our intangible assets, which include goodwill.

Fair Value Measurements: ASC Topic 820 Fair Value Measurements and Disclosures provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. Fair value is the price that could be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Based on the observability of the inputs used in the valuation techniques, we classify our financial assets and liabilities measured and disclosed at fair value in accordance with the three-level hierarchy (e.g., Level 1, Level 2 and Level 3) established under ASC Topic 820. Fair value determination in accordance with this guidance requires that we make a number of significant judgments. In determining the fair value of financial instruments, we use market prices of the same or similar instruments whenever such prices are available. We do not use prices involving distressed sellers in determining fair value. If observable market prices are unavailable or impracticable to obtain, then fair value is estimated using modeling techniques such as discounted cash flow analyses. These modeling techniques incorporate our assessments regarding assumptions that market participants would use in pricing the asset or the liability, including assumptions about the risks inherent in a particular valuation technique and the risk of nonperformance.

Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes in accordance with ASC Topic 825 Financial Instruments.

Deferred Income Tax Assets: At December 31, 2015, we had net deferred tax assets of $11.7 million. Based on our ability to offset the net deferred tax asset against taxable income in carryback years and expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at December 31, 2015. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryback/carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired.

BUSINESS SEGMENT RESULTS

We are organized and managed along two major business segments, as described in Note 19 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

Dollars in thousands	2015	2014	2013
Community banking	$17,216	$12,488	$9,576
Insurance & financial services	179	468	150
Parent and other	(1,293)	(2,371)	(2,433)
Consolidated net income	$16,102	$10,585	$7,293

RESULTS OF OPERATIONS

Earnings Summary

Net income applicable to common shares increased 52.1% during 2015 reaching $16.1 million, compared to $10.6 million in 2014, which was 45.1% greater than 2013's $7.3 million. On a per share basis, the income applicable to common shares was$1.50, $1.17, and $0.84 per diluted share for 2015, 2014, and 2013, respectively, representing 28.2% and 39.3% increases in 2015 and 2014, respectively. Return on average equity was 11.62% in 2015 compared to 9.54% in 2014 and 7.38% in 2013. Return on average assets for the year ended December 31, 2015 was 1.10% compared to 0.80% in 2014 and 0.58% in 2013. Included in 2015's net income was $2.4 million of write-downs of foreclosed properties to fair value. A summary of the significant factors influencing our results of operations and related ratios is included in the following discussion.

Net Interest Income

The major component of our net earnings is net interest income, which is the excess of interest earned on earning assets over the interest expense incurred on interest bearing sources of funds. Net interest income is affected by changes in volume, resulting from growth and alterations of the balance sheet's composition, fluctuations in interest rates and maturities of sources and uses of funds. We seek to maximize net interest income through management of our balance sheet components. This is accomplished by determining the optimal product mix with respect to yields on assets and costs of funds in light of projected economic conditions, while maintaining portfolio risk at an acceptable level.

Net interest income on a fully tax equivalent basis, average balance sheet amounts, and corresponding average yields on interest earning assets and costs of interest bearing liabilities for the years 2015, 2014, 2013, 2012 and 2011 are presented in Table I. Table II presents, for the periods indicated, the changes in interest income and expense attributable to (a) changes in volume (changes in volume multiplied by prior period rate) and (b) changes in rate (change in rate multiplied by prior period volume). Changes in interest income and expense attributable to both rate and volume have been allocated between the factors in proportion to the relationship of the absolute dollar amounts of the change in each.

Net interest income on a fully tax equivalent basis totaled $47.6 million, $43.9 million, and $40.2 million for the years ended December 31, 2015, 2014, and 2013, respectively, representing an increase of 8.5% in 2015 and 9.1% in 2014. During 2015 and 2014, the volumes of both interest earning assets and interest bearing liabilities increased, while during 2013, the volumes of both declined. During 2015, our earnings on interest earning assets increased $1.3 million as the increase in earnings due to higher volumes more than offset the reduction in yield, while the cost of interest bearing liabilities declined $2.4 million primarily due to lower volumes of long term borrowings and subordinated debentures. During 2014, our earnings on interest earning assets increased $415,000 as the increase in earnings due to higher volumes more than offset the reduction in yield, while the cost of interest bearing liabilities declined $3.2 million primarily due to maturing long term borrowings which were replaced with substantially lower cost short term borrowings. During 2013, the decline in earnings on interest earning assets of $6.7 million was partially offset by a reduction in the volume of interest bearing liabilities and a reduction in the cost of interest bearing liabilities. Total average earning assets increased 4.9 % to $1.36 billion at December 31, 2015 from $1.30 billion at December 31, 2014. Total average interest bearing liabilities increased 0.8% to $1.20 billion at December 31, 2015, compared to $1.19 billion at December 31, 2014. The growth in interest earning assets outpaced the growth in interest bearing liabilities, and was funded primarily by reductions in property held for sale, growth in noninterest bearing deposits, increased short term borrowings, and growth in equity. As identified in Table II, tax equivalent net interest income increased $3.7 million in both 2015 and 2014.

Our net interest margin was 3.50% for 2015 compared to 3.39% and 3.22% for 2014 and 2013, respectively. Our net interest margin increased 11 basis points in 2015 and 17 basis points in 2014. The cost of interest bearing liabilities decreased 20 and 30 basis points for 2015 and 2014, respectively, which more than offset the 11 and 14 basis point decrease in 2015 and 2014, respectively, in the yield on interest earning assets. See Tables I and II for further details regarding changes in volumes and rates of average assets and liabilities and how those changes affect our net interest income.

Assuming no significant change in market interest rates, we anticipate modest growth in our net interest income to continue over the near term due to growth in the volume of interest earning assets, primarily loans, coupled with expected moderate improvement in net interest margin over the same period. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. See the “Market Risk Management” section for further discussion of the impact changes in market interest rates could have on us. Further analysis of our yields on interest earning assets and interest bearing liabilities are presented in Tables I and

II below.

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Table I - Average Balances - Assets, Liabilities and Shareholders' Equity,
Interest Earnings & Expenses, and Average Yields/Rates

	Average Balances				
Dollars in thousands	2015	2014	2013	2012	2011
ASSETS					
Interest earning assets					
Loans, net of unearned interest (1)					
Taxable	$1,049,172	$984,723	$949,616	$963,209	$987,315
Tax-exempt (2)	13,706	7,823	5,440	6,628	5,105
Securities					
Taxable	209,316	211,700	208,588	233,560	252,901
Tax-exempt (2)	77,280	81,549	75,707	71,937	63,894
Federal Funds sold and interest bearing deposits with other banks	8,878	9,325	7,821	19,731	33,690
	1,358,352	1,295,120	1,247,172	1,295,065	1,342,905
Noninterest earning assets					
Cash and due from banks	3,839	3,756	4,381	4,188	4,022
Premises and equipment	20,707	20,346	20,926	21,578	22,620
Other assets	94,996	112,504	125,629	118,427	118,408
Allowance for loan losses	(11,307)	(11,724)	(15,152)	(18,157)	(18,161)
Total assets	$1,466,587	$1,420,002	$1,382,956	$1,421,101	$1,469,794
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities					
Interest bearing liabilities					
Interest bearing demand deposits	$208,160	$192,190	$181,413	$170,698	$152,552
Savings deposits	255,186	238,340	195,398	203,908	207,226
Time deposits	481,732	513,110	556,644	548,044	601,925
Short-term borrowings	151,102	100,786	34,098	13,248	4,238
Long-term borrowings and subordinated debentures	99,805	142,213	202,237	276,092	315,900
	1,195,985	1,186,639	1,169,790	1,211,990	1,281,841
Noninterest bearing liabilities					
Demand deposits	116,995	104,262	94,943	94,243	85,247
Other liabilities	15,024	10,119	8,951	8,256	8,474
Total liabilities	1,328,004	1,301,020	1,273,684	1,314,489	1,375,562
Shareholders' equity - preferred	1,786	9,276	9,313	9,326	4,738
Shareholders' equity - common	136,797	109,706	99,959	97,286	89,494
Total shareholders' equity	138,583	118,982	109,272	106,612	94,232
Total liabilities and shareholders' equity	$1,466,587	$1,420,002	$1,382,956	$1,421,101	$1,469,794
Net Interest Earnings					
Net Interest Margin					

(1) For purposes of this table, nonaccrual loans are included in average loan balances. Included in interest and fees on loans are loan fees of $473,000, $546,000, and $689,000 for the years ended December 31, 2015, 2014, and 2013, respectively.

(2)

For purposes of this table, interest income on tax-exempt securities and loans has been adjusted assuming an effective combined Federal and state tax rate of 34% for all years presented. The tax equivalent adjustment results in an increase in interest income of $1,542,000, $1,465,000, and $1,396,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

Table I - Average Balances - Assets, Liabilities and Shareholders' Equity,
Interest Earnings & Expenses, and Average Yields/Rates (cont'd)

	Interest Earnings/Expense					Average Yield/Rate				
Dollars in thousands	2015	2014	2013	2012	2011	2015	2014	2013	2012	2011
ASSETS										
Interest earning assets										
Loans, net of unearned interest (1)										
Taxable	$51,554	$50,078	$50,505	$55,248	$58,911	4.91 %	5.09 %	5.32 %	5.74 %	5.97 %
Tax-exempt (2)	779	533	388	483	402	5.68 %	6.81 %	7.13 %	7.29 %	7.87 %
Securities										
Taxable	4,328	4,692	4,131	5,689	9,106	2.07 %	2.22 %	1.98 %	2.44 %	3.60 %
Tax-exempt (2)	3,756	3,780	3,647	3,929	4,080	4.86 %	4.64 %	4.82 %	5.46 %	6.39 %
Federal Funds sold and interest bearing deposits with other banks	8	8	5	35	72	0.09 %	0.09 %	0.06 %	0.18 %	0.21 %
	60,425	59,091	58,676	65,384	72,571	4.45 %	4.56 %	4.70 %	5.05 %	5.40 %
LIABILITIES AND SHAREHOLDERS' EQUITY										
Liabilities										
Interest bearing liabilities										
Interest bearing demand deposits	251	222	255	325	391	0.12 %	0.12 %	0.14 %	0.19 %	0.26 %
Savings deposits	1,781	1,580	1,152	1,361	1,899	0.70 %	0.66 %	0.59 %	0.67 %	0.92 %
Time deposits	6,304	7,193	8,985	11,472	15,983	1.31 %	1.40 %	1.61 %	2.09 %	2.66 %
Short-term borrowings	525	306	95	31	8	0.35 %	0.30 %	0.28 %	0.23 %	0.19 %
Long-term borrowings subordinated debentures	4,007	5,940	7,991	10,875	12,921	4.01 %	4.18 %	3.95 %	3.94 %	4.09 %
	12,868	15,241	18,478	24,064	31,202	1.08 %	1.28 %	1.58 %	1.99 %	2.43 %

$47,557	$43,850	$40,198	$41,320	$41,369						
					3.50 %	3.39 %	3.22 %	3.19 %	3.08 %	

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Table II - Changes in Interest Margin Attributable to Rate and Volume

	2015 Versus 2014 Increase (Decrease) Due to Change in:			2014 Versus 2013 Increase (Decrease) Due to Change in:		
Dollars in thousands	Volume	Rate	Net	Volume	Rate	Net
Interest earned on						
Loans						
Taxable	$3,205	$(1,729)	$1,476	$1,830	$(2,257)	$(427)
Tax-exempt	347	(101)	246	163	(18)	145
Securities						
Taxable	(52)	(312)	(364)	63	498	561
Tax-exempt	(203)	179	(24)	274	(141)	133
Federal funds sold and interest bearing deposits with other banks	—	—	—	1	2	3
Total interest earned on interest earning assets	3,297	(1,963)	1,334	2,331	(1,916)	415
Interest paid on						
Interest bearing demand deposits	19	10	29	14	(47)	(33)
Savings deposits	115	86	201	273	155	428
Time deposits	(426)	(463)	(889)	(669)	(1,123)	(1,792)
Short-term borrowings	170	49	219	202	9	211
Long-term borrowings and subordinated debentures	(1,710)	(223)	(1,933)	(2,486)	435	(2,051)
Total interest paid on interest bearing liabilities	(1,832)	(541)	(2,373)	(2,666)	(571)	(3,237)
Net interest income	$5,129	$(1,422)	$3,707	$4,997	$(1,345)	$3,652

Noninterest Income

Noninterest income totaled 0.81%, 0.79%, and 0.81%, of average assets in 2015, 2014, and 2013, respectively. Noninterest income totaled $11.9 million in 2015 compared to $11.2 million in both 2014 and 2013. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest Income

Dollars in thousands	2015	2014	2013
Insurance commissions	$4,042	$4,400	$4,429
Service fees related to deposit accounts	4,285	4,405	4,326
Realized securities gains	1,444	213	240
Other-than-temporary impairment of securities	—	(1)	(118)
Bank owned life insurance income	1,040	1,071	994
Other	1,050	1,135	1,338
Total	$11,861	$11,223	$11,209

Other-than-temporary impairment of securities: We do not anticipate material charges for other-than-temporary impairment of securities in the near term.

Noninterest Expense

Noninterest expense was well controlled in both 2015 and 2014. These expenses totaled $33.6 million, $35.3 million, and $34.8 million, or 2.3%, 2.5%, and 2.5% of average assets for each of the years ended December 31, 2015, 2014, and 2013. Total noninterest expense decreased $1.7 million in 2015 compared to 2014 and increased $568,000 in 2014 compared to 2013. Our most notable change in noninterest expense during 2015 was the reduction in write-downs of foreclosed properties. Table IV below shows the breakdown of these changes.

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Table IV - Noninterest Expense

Dollars in thousands	2015	Change $	Change %	2014	Change $	Change %	2013
Salaries, commissions, and employee benefits	$17,638	$1,453	9.0 %	$16,185	$7	— %	$16,178
Net occupancy expense	1,964	(59)	(2.9)%	2,023	170	9.2 %	1,853
Equipment expense	2,294	208	10.0 %	2,086	(217)	(9.4)%	2,303
Professional fees	1,616	187	13.1 %	1,429	248	21.0 %	1,181
Amortization of intangibles	200	(50)	(20.0)%	250	(101)	(28.8)%	351
FDIC premiums	1,220	(572)	(31.9)%	1,792	(268)	(13.0)%	2,060
Foreclosed properties expense	684	(336)	(32.9)%	1,020	(25)	(2.4)%	1,045
Loss on sales of foreclosed properties	(26)	(853)	(103.1)%	827	309	59.7 %	518
Write-downs of foreclosed properties	2,415	(1,356)	(36.0)%	3,771	49	1.3 %	3,722
Other	5,627	(314)	(5.3)%	5,941	396	7.1 %	5,545
Total	$33,632	$(1,692)	(4.8)%	$35,324	$568	1.6 %	$34,756

Salaries, commissions, and employee benefits: These expenses are 9% higher in 2015 compared to 2014 due to an increase in number of employees, general merit raises, and increased incentive accruals based upon performance.

Professional fees: Professional fees increased 13% in 2015 and 21% in 2014, as a result of higher legal fees related to matters in litigation.

FDIC premiums: FDIC premiums decreased 32% during 2015 and 13% during 2014, reflecting a reduction in rate due to Summit Community's release from its MOU in late 2014. These lower levels are expected to continue.

Write-downs of foreclosed properties: These write-downs declined 36% during 2015. Management expects such write-downs to continue to trend lower than in recent years.

Other: Other expenses decreased during 2015 and increased during 2014 principally due to recognition of a $461,000 fraud loss in 2014.

Income Tax Expense/Benefit

Income tax expense for the years ended December 31, 2015, 2014, and 2013 totaled $6.9 million, $4.7 million, and $2.7 million, respectively. Refer to Note 13 of the accompanying consolidated financial statements for further information and additional discussion of the significant components influencing our effective income tax rates.

CHANGES IN FINANCIAL POSITION

Our average assets increased during 2015 to $1.47 billion, an increase of 3.3% above 2014's average of $1.42 billion, and our year end December 31, 2015 assets were $48.9 million more than December 31, 2014. Average assets increased 2.7% in 2014, from $1.38 billion in 2013. Significant changes in the components of our balance sheet in 2015 and 2014 are discussed below.

Loan Portfolio

Table V depicts gross loan balances by type and the respective percentage of each to total loans at December 31, as follows:

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Table V - Loans by Type

	2015		2014		2013		2012		2011	
Dollars in thousands	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial	$97,201	8.9 %	$88,688	8.6 %	$88,405	9.3 %	$85,908	9.0 %	$99,101	10.1 %
Commercial real estate	540,849	49.5 %	475,343	46.0 %	430,804	45.3 %	430,837	45.0 %	429,531	43.5 %
Construction and development	75,470	6.9 %	96,630	9.4 %	86,712	9.1 %	83,155	8.7 %	96,013	9.8 %
Residential mortgage	346,363	31.8 %	340,269	33.0 %	321,541	33.8 %	331,980	34.7 %	334,688	34.0 %
Consumer	19,251	1.8 %	19,500	1.9 %	19,900	2.1 %	20,658	2.2 %	22,377	2.3 %
Other	11,669	1.1 %	11,522	1.1 %	3,279	0.4 %	3,703	0.4 %	2,765	0.3 %
Total loans	$1,090,803	100.0 %	$1,031,952	100.0 %	$950,641	100.0 %	$956,241	100.0 %	$984,475	100.0 %

Total net loans averaged $1.1 billion in 2015, which represented 72% of total average assets compared to $992.5 million in 2014, or 70% of total average assets. A continued improving economic environment in our market area contributed to 5.7% loan growth in 2015, following 2014's growth of 8.6% -- the first year of such growth since the onset of the economic downturn in 2008.

Refer to Note 5 of the accompanying consolidated financial statements for our loan maturities and a discussion of our adjustable rate loans as of December 31, 2015.

In the normal course of business, we make various commitments and incur certain contingent liabilities, which are disclosed in Note 15 of the accompanying consolidated financial statements but not reflected in the accompanying consolidated financial statements. There have been no significant changes in these types of commitments and contingent liabilities and we do not anticipate any material losses as a result of these commitments.

Securities

Securities comprised approximately 18.8% of total assets at December 31, 2015 compared to 19.6% at December 31, 2014. Average securities approximated $286.6 million for 2015 or 2.3% less than 2014's average of $293.2 million. Refer to Note 4 of the accompanying consolidated financial statements for details of amortized cost, the estimated fair values, unrealized gains and losses as well as the security classifications by type.

All of our securities are classified as available for sale to provide us with flexibility to better manage our balance sheet structure and react to asset/liability management issues as they arise. Pursuant to ASC Topic 320 Investments—Debt and Equity Securities, anytime that we carry a security with an unrealized loss that has been determined to be “other-than-temporary”, we must recognize that loss in income. During 2014 and 2013, we took other-than-temporary non-cash impairment charges of $1,000 and $118,000, respectively, related to certain nongovernment sponsored residential mortgage-backed securities.

At December 31, 2015, we did not own securities of any one issuer that were not issued by the U.S. Treasury or a U.S. Government agency that exceeded ten percent of shareholders’ equity. The maturity distribution of the securities portfolio at December 31, 2015, together with the weighted average yields for each range of maturity, is summarized in Table VI. The stated average yields are stated on a tax equivalent basis.

Table VI - Securities Maturity Analysis

(At amortized cost, dollars in thousands)	Within one year Amount	Yield		After one but within five years Amount	Yield		After five but within ten years Amount	Yield		After ten years Amount	Yield	
U. S. Government agencies and corporations	$195	4.0	%	$3,594	3.2	%	$8,906	2.3	%	$7,767	2.3	%
Residential mortgage backed securities:												
Government sponsored agencies	48,242	2.7	%	90,703	2.3	%	5,312	2.6	%	1,329	3.5	%
Nongovernment sponsored entities	4,114	3.2	%	3,375	2.6	%	344	4.1	%	3	24.2	%
State and political subdivisions	250	3.0	%	3,389	4.5	%	4,937	4.7	%	79,412	4.3	%
Corporate debt securities	—	—		—	—		1,750	3.5	%	12,744	2.7	%
Other	—	—		—	—		—	—		77	—	
Total	$52,801	2.7	%	$101,061	2.4	%	$21,249	3.1	%	$101,332	3.9	%

Deposits

Total deposits at December 31, 2015 increased $5.4 million or 1% compared to December 31, 2014. We have strengthened our focus on growing core transaction accounts, which is reflected by their 4.8% growth during 2015, and 35.4% growth over the past five years.

Table VII - Deposits

Dollars in thousands	2015	2014	2013	2012	2011
Noninterest bearing demand	$119,010	$115,427	$92,837	$100,592	$88,655
Interest bearing demand	215,721	204,030	186,578	175,706	158,483
Savings	266,825	253,578	193,446	193,039	208,809
Time deposits	465,153	488,279	530,951	557,788	560,553
Total deposits	$1,066,709	$1,061,314	$1,003,812	$1,027,125	$1,016,500

See Table I for average deposit balance and rate information by deposit type for the past five years, and Note 10 of the accompanying consolidated financial statements for a maturity distribution of time deposits as of December 31, 2015.

Borrowings

Lines of Credit: We have a remaining available line of credit from the Federal Home Loan Bank of Pittsburgh ("FHLB") totaling $377.8 million at December 31, 2015. We use this line primarily to fund loans to customers. Funds acquired through this program are reflected on the consolidated balance sheet in short-term borrowings or long-term borrowings, depending on the repayment terms of the debt agreement. We also had $92.0 million available on a short term line of credit with the Federal Reserve Bank at December 31, 2015, which is primarily secured by consumer loans, construction loans, and commercial and industrial loans and a $6 million available line of credit with a correspondent bank.

Short-term Borrowings: Total short-term borrowings consisting primarily of advances from the FHLB having original maturities of 30 days or less increased $47.8 million from $123.6 million at December 31, 2014 to $171.4 million at

December 31, 2015. See Note 11 of the accompanying consolidated financial statements for additional disclosures regarding our short-term borrowings.

Long-term Borrowings: Long-term borrowings historically have been used to fund our loan growth, however, as a result of prolonged low short-term interest rates following the economic downturn of 2008, long-term borrowings have been reduced significantly as we have replaced maturing long-term borrowings with short-term funding. Total long-term borrowings of $75.6 million at December 31, 2015 and $77.5 million at December 31, 2014 consisted primarily of structured reverse repurchase agreements with two unaffiliated institutions. Long-term borrowings from the FHLB totaled $873,000 at December 31, 2015, compared to $976,000 outstanding at December 31, 2014. At December 31, 2015, we had a $2.7 million term loan which is secured by the common stock of our subsidiary bank and bears a variable interest rate of prime minus 50 basis points with a final maturity of 2017. During 2007, we entered into $110 million of structured reverse repurchase agreements, with terms ranging from 5 to 10 years and call features ranging from 2 to 3.5 years in which they are callable by the

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purchaser. These structured reverse repurchase agreements totaled $72.0 million at December 31, 2015. Refer to Note 11 of the accompanying consolidated financial statements for additional information regarding our long-term borrowings.

Subordinated Debentures: During 2015, we prepaid in full the $16.8 million subordinated debentures that were outstanding at December 31, 2014. The subordinated debt qualified as Tier 2 capital under Federal Reserve Board guidelines until the debt was within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital was reduced by 20 percent each year until maturity. During 2009, we issued $6.8 million in subordinated debt, of which $5 million was issued to an affiliate of a director of Summit. We also issued $1.0 million and $0.8 million to two unrelated parties. These three issuances had an interest rate of 10 percent per annum, a term of 10 years, and were not prepayable by us within the first five years. During 2008, we issued $10 million of subordinated debt to an unrelated institution, which had a variable interest rate of 1 month LIBOR plus 275 basis points and a term of 7.5 years.

ASSET QUALITY

As a result of a historically slow economic recovery, our foreclosed properties portfolio remains elevated relative to our peers. Prior elevated levels of nonperforming loans have returned to acceptable levels. Management expects net reductions in foreclosed properties to continue, although not as rapid as over the past two years.

For purposes of this discussion, we define nonperforming assets to include foreclosed properties, other repossessed assets, and nonperforming loans, which is comprised of loans 90 days or more past due and still accruing interest and nonaccrual loans. Performing TDRs are excluded from nonperforming loans.

Table VIII presents a summary of nonperforming assets at December 31, as follows:

Table VIII - Nonperforming Assets

Dollars in thousands	2015	2014	2013	2012	2011
Accruing loans past due 90 days or more					
Commercial	$—	$—	$—	$—	$—
Residential construction & development	—	—	—	—	344
Residential real estate	—	—	—	—	—
Consumer	9	—	—	—	—
Other	—	—	—	—	—
Total accruing loans 90+ days past due	9	—	—	—	344
Nonaccrual loans					
Commercial	853	392	1,224	5,002	3,260
Commercial real estate	5,955	1,844	2,318	2,556	7,163
Commercial construction & development	—	—	3,782	—	1,052
Residential construction & development	5,623	4,619	9,048	13,641	22,289
Residential real estate	3,245	5,556	2,446	16,522	18,187
Consumer	83	83	128	55	145
Total nonaccrual loans	15,759	12,494	18,946	37,776	52,096
Foreclosed properties					
Commercial	—	110	—	—	—
Commercial real estate	1,300	5,204	9,903	11,835	15,721
	8,717	10,179	11,125	17,597	17,101

Commercial construction & development										
Residential construction & development	14,069		19,267		20,485		23,074		27,877	
Residential real estate	1,481		2,769		11,879		3,666		3,239	
Total foreclosed properties	25,567		37,529		53,392		56,172		63,938	
Repossessed assets	5		221		8		6		263	
Total nonperforming assets	$41,340		$50,244		$72,346		$93,954		$116,641	
Total nonperforming loans as a percentage of total loans	1.45	%	1.21	%	1.99	%	3.96	%	5.33	%
Total nonperforming assets as a percentage of total assets	2.77	%	3.48	%	5.22	%	6.77	%	8.04	%
Allowance for loan losses as a percentage of nonperforming loans	72.75	%	89.38	%	66.82	%	47.47	%	33.78	%
Allowance for loan losses as a percentage of period end loans	1.05	%	1.08	%	1.33	%	1.88	%	1.80	%

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Refer to Note 5 Loans, for information regarding our past due loans, impaired loans, nonaccrual loans, and troubled debt restructurings.

We monitor our concentrations in higher-risk lending areas in accordance with the Interagency Guidance for Concentrations in Commercial Real Estate Lending issued in 2006. This guidance establishes concentration guidelines of 100% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development, and other land loans. It further establishes a guideline of 300% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development and other land loans plus loans secured by non-owner occupied non-farm non-residential properties. As of December 31, 2015, Summit Community Bank was within the recommended limits of 100% and 300%, respectively.

We maintain the allowance for loan losses at a level considered adequate to provide for estimated probable credit losses inherent in the loan portfolio. The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology we employ on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is provided in Note 6 of the accompanying financial statements.

Relationship between Allowance for Loan Losses, Net Charge-offs and Nonperforming Loans

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above.

Charge-offs, if necessary, are typically recognized in a period after the reserves were established. If the previously established reserves exceed that needed to satisfactorily resolve the problem credit, a reduction in the overall level of the reserve could be recognized. In summary, if loan quality deteriorates, the typical credit sequence consists of periods of reserve building, followed by periods of higher net charge-offs.

Consumer loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Commercial-related loans (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination includes many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower’s equity.

Substantially all of our nonperforming loans are secured by real estate. The majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. The fair values of the underlying collateral value or the discounted cash flows remain in excess of the recorded investment in many of our nonperforming loans, and therefore, no specific reserve allocation is required.

At December 31, 2015 and 2014, our allowance for loan losses totaled $11.5 million, or 1.05% of total loans and $11.2 million, or 1.08% of total loans, respectively, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio. The 2015 decline as a percentage of total loans is a result of lower average loan losses experienced over the past twelve quarters. Lower losses cause our historical charge-off factor of the quantitative reserve calculation to decline, thus requiring fewer quantitative reserves. Table IX presents an allocation of the allowance for loan losses by loan type at each respective year end date, as follows:

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Table IX - Allocation of the Allowance for Loan Losses

Dollars in thousands	2015 Amount	2015 % of loans in each category to total loans		2014 Amount	2014 % of loans in each category to total loans		2013 Amount	2013 % of loans in each category to total loans		2012 Amount	2012 % of loans in each category to total loans		2011 Amount	2011 % of loans in each category to total loans	
Commercial	$781	8.9	%	$1,204	8.6	%	$1,323	9.3	%	$782	9.0	%	$770	10.1	%
Commercial real estate	4,566	49.6	%	2,244	46.0	%	1,610	45.3	%	4,656	45.1	%	4,618	43.6	%
Construction and development	2,867	6.9	%	3,844	9.4	%	5,724	9.1	%	5,358	8.7	%	7,381	9.8	%
Residential real estate	3,099	31.7	%	3,547	33.0	%	3,904	33.8	%	6,984	34.7	%	4,749	34.0	%
Consumer	59	1.8	%	97	1.9	%	48	2.1	%	132	2.1	%	161	2.3	%
Other	100	1.1	%	231	1.1	%	50	0.4	%	21	0.4	%	33	0.2	%
Total	$11,472	100.0	%	$11,167	100.0	%	$12,659	100.0	%	$17,933	100.0	%	$17,712	100.0	%

A reconciliation of the activity in the allowance for loan losses follows:

Table X - Allowance for Loan Losses

Dollars in thousands	2015	2014	2013	2012	2011
Balance, beginning of year	$11,167	$12,659	$17,933	$17,712	$17,224
Losses					
Commercial	77	390	723	1,273	506
Commercial real estate	737	11	1,040	1,442	586
Construction and development	457	3,535	3,596	3,757	3,568
Residential real estate	701	514	5,359	2,114	5,035
Consumer	69	265	79	136	162
Other	110	118	162	95	86
Total	2,151	4,833	10,959	8,817	9,943
Recoveries					
Commercial	10	34	12	13	35
Commercial real estate	303	358	682	64	92
Construction and development	456	298	187	61	43
Residential real estate	206	254	138	228	98
Consumer	105	74	79	95	112
Other	126	73	87	77	51
Total	1,206	1,091	1,185	538	431
Net losses	945	3,742	9,774	8,279	9,512
Provision for loan losses	1,250	2,250	4,500	8,500	10,000
Balance, end of year	$11,472	$11,167	$12,659	$17,933	$17,712

At December 31, 2015 and 2014, we had approximately $25.6 million and $37.5 million, respectively, in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

LIQUIDITY AND CAPITAL RESOURCES

Bank Liquidity: Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by excess funds at correspondent banks, non-pledged securities, and available lines of credit with the FHLB, Federal Reserve Bank of Richmond and correspondent banks, which totaled approximately $628.8 million or 42.1% of total consolidated assets at December 31, 2015.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to borrow approximately $546.6 million. At December 31, 2015, we had available borrowing capacity of $377.8 million on our FHLB line. We also maintain a credit line with the Federal Reserve Bank of Richmond as a contingency liquidity vehicle. The amount available on this line at December 31, 2015 was approximately $92 million, which is secured by a pledge of our consumer loans, construction loans, and commercial and industrial loan portfolios. We have a $6 million unsecured line of credit with a correspondent bank. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises. During 2015, our loans increased approximately $59.5 million, while total deposits increased $5.4 million. This additional liquidity need was met primarily by FHLB short-term advances.

Liquidity risk represents the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, customer or creditor perception of financial strength, and events unrelated to Summit such as war, terrorism, or financial institution market specific issues. The Asset/Liability Management Committee ("ALCO"), comprised of members of senior management and certain members of the Board of Directors, oversees our liquidity risk management process. The ALCO develops and recommends policies and limits governing our liquidity to the Board of Directors for approval with the objective of ensuring that we can obtain cost-effective funding to meet current and future obligations, as well as maintain sufficient levels of on-hand liquidity, under both normal and "stressed" circumstances.
Refer to page 14 of Item 1A. Risk Factors for further discussion of our liquidity risk.

We continuously monitor our liquidity position to ensure that day-to-day as well as anticipated funding needs are met. We are not aware of any trends, commitments, events or uncertainties that have resulted in or are reasonably likely to result in a material change to our liquidity.

Growth and Expansion: During 2015, we spent approximately $2.5 million on capital expenditures for premises and equipment. We expect our capital expenditures to approximate $2 - $3 million in 2016, primarily for equipment upgrades, office renovations, and new branch construction.

Management anticipates that the Company's assets will grow in 2016 at a pace comparable to the 3% growth it experienced in 2015.

Capital Compliance: Our capital position is strong. Stated as a percentage of total assets, our equity ratio was 9.6% at December 31, 2015 compared to 9.1% at December 31, 2014. Our subsidiary bank, Summit Community Bank, had Tier 1 risk-based, Total risk-based and Tier 1 leverage capital in excess of the minimum "well capitalized" levels of $65.1 million, $52.6 million, and $84.9 million, respectively. We intend to maintain both Summit's and its subsidiary bank's capital ratios at levels that would be considered to be "well capitalized" in accordance with regulatory capital guidelines. See Note 18 of the accompanying consolidated financial statements for further discussion of our regulatory capital.

In July 2013, our primary federal regulator, the Federal Reserve, published final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The rules are discussed under Capital Requirements in the Supervision and Regulation section of Part I.

Summit had outstanding $3.7 million of 8% non-cumulative convertible preferred stock issued in 2009 and an additional $5.8 million of 8% non-cumulative convertible preferred stock issued in 2011 that was fully converted to common stock on March 12, 2015.

On August 25, 2014, we entered into a Securities Purchase Agreement ("SPA") agreeing to sell 1,057,137 shares of common stock (representing approximately 9.9% of our outstanding common stock) at the price of $9.75 per share to Castle Creek Capital Partners V, LP ("Castle Creek") in a private placement. The private placement with Castle Creek consisted of two (2) closings. The first closing for the purchase of 819,384 shares of common stock at an aggregate price of $7,988,994 was consummated on November 25, 2014. The second closing for the purchase of 237,753 shares of common stock at an aggregate price of $2,318,092 was consummated on March 17, 2015 and was conditioned upon, among other things, the conversion into shares of common stock of all of the outstanding shares of our 8%

Non-Cumulative Convertible Preferred Stock, Series 2009 and our 8% Non-Cumulative Convertible Preferred Stock, Series 2011 ("the Conversions"), in accordance with the terms of our Articles of Incorporation, as amended.

We also agreed under the terms of the SPA to commence, following the second closing of the sale of Common Stock to Castle Creek under the SPA, a rights offering (the “Rights Offering”) to the holders of record of the Common Stock as of a date selected by Summit’s Board of Directors. In the Rights Offering, all holders of Common Stock as of the record date, excluding Castle Creek, were offered non-transferable rights (“Rights”) to purchase shares of Common Stock at the same per share purchase price of $9.75 used in the Private Placement to Castle Creek. The aggregate number of shares offered for sale in connection with the Rights Offering was 256,410 shares, with 256,167 shares being issued yielding total gross proceeds of approximately $2.5 million, prior to any fees and expenses associated with the sale. The Rights were distributed to all of the holders of the Common Stock, excluding Castle Creek, on a pro rata basis, based on the number of shares of Common Stock owned by each shareholder as of April 10, 2015, the record date used in connection with the Rights Offering. The Rights Offering expired May 29, 2015.

On March 30, 2015, we repurchased 100,000 shares of our common stock from First Bank of Charleston, Inc. in a privately negotiated transaction for an aggregate purchase price of $1,080,000 and retired the shares.

On July 30, 2015, our Employee Stock Ownership Plan ("ESOP") purchased 225,000 shares of Summit Financial Group Inc. common stock, which is shown as a reduction of shareholders' equity, similar to a purchase of treasury stock. When the shares are committed to be released and become available for allocation to plan participants, the then fair value of such shares will be charged to compensation expense. Unallocated shares owned by the Company's ESOP are not considered to be outstanding for the purpose of computing earnings per share.

Dividends: Cash dividends per share totaled $0.32 during 2015, representing a dividend payout ratio of 20.7%. There were no cash dividends paid on common shares in 2014. It is our intention to continue to pay dividends on a quarterly basis during 2016. Future dividend amounts will depend on the earnings and financial condition of our subsidiary bank as well as general economic conditions.

The primary source of funds for the dividends paid to our shareholders is dividends received from our subsidiary bank. Dividends paid by our subsidiary bank are subject to restrictions by banking law and regulations and require approval by the bank's regulatory agency if dividends declared in any year exceed the bank's current year's net income, as defined, plus its retained net profits of the two preceding years. In addition, cash dividends depend on the earnings, and financial condition of our subsidiary bank and our capital adequacy as well as general economic conditions. During 2016, the net retained profits available for distribution to Summit as dividends without regulatory approval are approximately $12.8 million.

Contractual Cash Obligations: During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at December 31, 2015.

Table XI - Contractual Cash Obligations

Dollars in thousands	Long Term Debt and Subordinated Debentures	Operating Leases
2016	$28,911	$257
2017	919	215
2018	45,017	162
2019	18	136
2020	18	23
Thereafter	20,287	—
Total	$95,170	$793

Off-Balance Sheet Arrangements: We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at December 31, 2015 are presented in the following table. Refer to Note 15 of the accompanying consolidated financial statements for further discussion of our off-balance sheet arrangements.

Table XII - Off-Balance Sheet Arrangements

Dollars in thousands	
Commitments to extend credit	
Revolving home equity and credit card lines	$58,008
Construction loans	32,044
Other loans	49,775
Standby letters of credit	5,302

Total	$145,129

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Item 7A. Quantitative and Qualitative Disclosures about Market Risk

MARKET RISK MANAGEMENT

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. Interest rate risk is our primary market risk and results from timing differences in the repricing of assets, liabilities and off-balance sheet instruments, changes in relationships between rate indices and the potential exercise of embedded options. The principal objective of asset/liability management is to minimize interest rate risk and our actions in this regard are taken under the guidance of our Asset/Liability Management Committee ("ALCO"). The ALCO is comprised of members of the Board of Directors and of members of senior management. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. At December 31, 2015, our interest rate risk position was liability sensitive. That is, liabilities are likely to reprice faster than assets, resulting in a decrease in net interest income in a rising rate environment, while a falling interest rate environment would produce an increase in net interest income. Net interest income is also subject to changes in the shape of the yield curve. In general, a flat yield curve results in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

Several techniques are available to monitor and control the level of interest rate risk. We primarily use earnings simulations modeling to monitor interest rate risk. The earnings simulation model forecasts the effects on net interest income under a variety of interest rate scenarios that incorporate changes in the absolute level of interest rates and changes in the shape of the yield curve. Each increase or decrease in rates is assumed to gradually take place over a 12 month period, and then remain stable, except for the up 400 scenario, which assumes a gradual increase in rates over 24 months. Assumptions used to project yields and rates for new loans and deposits are derived from historical analysis. Securities portfolio maturities and prepayments are reinvested in like instruments. Mortgage loan prepayment assumptions are developed from industry estimates of prepayment speeds. Noncontractual deposit repricings are modeled on historical patterns.

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of December 31, 2015. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limits shown below relative to reductions in net interest income over the ensuing twelve month period.

	Estimated % Change in Net Interest Income over:					
Change in	0 - 12 Months				13 - 24 Months	
Interest Rates	Policy		Actual		Actual	
Down 100 basis points (1)	-7	%	0.99	%	-0.09	%
Up 200 basis points (1)	-10	%	-3.94	%	-4.12	%
Up 400 basis points (2)	-15	%	-3.18	%	-6.51	%

(1) assumes a parallel shift in the yield curve over 12 months
(2) assumes a parallel shift in the yield curve over 24 months

REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

Summit Financial Group, Inc. is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

We, as management of Summit Financial Group, Inc., are responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles and in conformity with the Federal Financial Institutions Examination Council instructions for consolidated Reports of Condition and Income (call report instructions). The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Audit Committee, consisting entirely of independent directors, meets regularly with management, internal auditors and the independent registered public accounting firm, and reviews audit plans and results, as well as management's actions taken in discharging responsibilities for accounting, financial reporting, and internal control. Arnett Carbis Toothman LLP, independent registered public accounting firm, and the internal auditors have direct and confidential access to the Audit Committee at all times to discuss the results of their examinations.

Management assessed the Corporation's system of internal control over financial reporting as of December 31, 2015. In making this assessment, we used the criteria for effective internal control over financial reporting set forth in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013. Based on this assessment, management concludes that, as of December 31, 2015, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control-Integrated Framework. Arnett Carbis Toothman LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of the Corporation's internal control over financial reporting.

Management is also responsible for compliance with the federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations.

/s/ H. Charles Maddy, III President and Chief Executive Officer	/s/ Robert S. Tissue Senior Vice President and Chief Financial Officer	/s/ Julie R. Markwood Vice President and Chief Accounting Officer

Moorefield, West Virginia
February 26, 2016

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders
Summit Financial Group, Inc.
Moorefield, West Virginia

We have audited Summit Financial Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Summit Financial Group, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards established by the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Summit Financial Group, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based upon the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Summit Financial Group, Inc. and subsidiaries, and our report, dated February 26, 2016, expressed an unqualified opinion.

Charleston, West Virginia
February 26, 2016

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Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Summit Financial Group, Inc.
Moorefield, West Virginia

We have audited the accompanying consolidated balance sheets of Summit Financial Group, Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Summit Financial Group, Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Summit Financial Group, Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 26, 2016, expressed an unqualified opinion on the effectiveness of Summit Financial Group Inc. and subsidiaries’ internal control over financial reporting.

Charleston, West Virginia
February 26, 2016

Consolidated Balance Sheets

	December 31,	
Dollars in thousands	2015	2014
ASSETS		
Cash and due from banks	$3,625	$3,728
Interest bearing deposits with other banks	5,862	8,782
Cash and cash equivalents	9,487	12,510
Securities available for sale	280,792	282,834
Other investments	8,949	6,183
Loan held for sale	779	527
Loans, net	1,079,331	1,019,842
Property held for sale	25,567	37,529
Premises and equipment, net	21,572	20,060
Accrued interest receivable	5,544	5,838
Intangible assets	7,498	7,698
Cash surrender value of life insurance policies	37,732	36,700
Other assets	15,178	13,847
Total assets	$1,492,429	$1,443,568
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non-interest bearing	$119,010	$115,427
Interest bearing	947,699	945,887
Total deposits	1,066,709	1,061,314
Short-term borrowings	171,394	123,633
Long-term borrowings	75,581	77,490
Subordinated debentures	—	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589
Other liabilities	15,412	13,098
Total liabilities	1,348,685	1,311,924
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock and related surplus, authorized 250,000 shares:		
Series 2009, 8% Non-cumulative convertible preferred stock, par value $1.00; issued 2014 - 3,610 shares	—	3,419
Series 2011, 8% Non-cumulative convertible preferred stock, par value $1.00; issued 2014 - 11,914 shares	—	5,764
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares; issued 2015 - 10,671,744 shares; 2014 - 8,301,746 shares	45,741	32,670
Unallocated common stock held by Employee Stock Ownership Plan - 2015 - 181,822 shares	(1,964)	—
Retained earnings	100,423	87,719
Accumulated other comprehensive income (loss)	(456)	2,072
Total shareholders' equity	143,744	131,644
Total liabilities and shareholders' equity	$1,492,429	$1,443,568

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

For the Year Ended December 31,

Dollars in thousands (except per share amounts)	2015	2014	2013
Interest income			
Interest and fees on loans			
Taxable	$51,554	$50,078	$50,485
Tax-exempt	514	352	256
Interest and dividends on securities			
Taxable	4,329	4,693	4,127
Tax-exempt	2,479	2,495	2,407
Interest on interest bearing deposits with other banks	7	8	5
Total interest income	58,883	57,626	57,280
Interest expense			
Interest on deposits	8,336	8,995	10,392
Interest on short-term borrowings	525	306	94
Interest on long-term borrowings and subordinated debentures	4,006	5,940	7,991
Total interest expense	12,867	15,241	18,477
Net interest income	46,016	42,385	38,803
Provision for loan losses	1,250	2,250	4,500
Net interest income after provision for loan losses	44,766	40,135	34,303
Noninterest income			
Insurance commissions	4,042	4,400	4,429
Service fees related to deposit accounts	4,285	4,405	4,326
Realized securities gains	1,444	213	240
Bank owned life insurance income	1,040	1,071	994
Other	1,050	1,135	1,338
Total other-than-temporary impairment loss on securities	—	(1)	(155)
Portion of loss recognized in other comprehensive income	—	—	37
Net impairment loss recognized in earnings	—	(1)	(118)
Total noninterest income	11,861	11,223	11,209
Noninterest expenses			
Salaries, commissions, and employee benefits	17,638	16,185	16,178
Net occupancy expense	1,964	2,023	1,853
Equipment expense	2,294	2,086	2,303
Professional fees	1,616	1,429	1,181
Amortization of intangibles	200	250	351
FDIC premiums	1,220	1,792	2,060
Foreclosed properties expense	684	1,020	1,045
Loss (gain) on sales of foreclosed properties	(26)	827	518
Write-downs of foreclosed properties	2,415	3,771	3,722
Other	5,627	5,941	5,545
Total noninterest expenses	33,632	35,324	34,756
Income before income tax expense	22,995	16,034	10,756
Income tax expense	6,893	4,678	2,688
Net income	16,102	11,356	8,068
Dividends on preferred shares	—	771	775
Net income applicable to common shares	$16,102	$10,585	$7,293
Basic earnings per common share	$1.56	$1.40	$0.98
Diluted earnings per common share	$1.50	$1.17	$0.84

See Notes to Consolidated Financial Statements

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Consolidated Statements of Comprehensive Income

	For the Year Ended December 31,		
Dollars in thousands	2015	2014	2013
Net income	$16,102	$11,356	$8,068
Other comprehensive income (loss):			
Net unrealized gain (loss) on cashflow hedge of:			
2015 - ($2,160), net of deferred taxes of ($799); 2014 - ($3,714), net of deferred taxes of ($1,374); 2013 - 803, net of deferred taxes of $297	(1,361)	(2,340)	506
Non-credit related other-than-temporary impairment on available for sale debt securities:			
2013 - $37, net of deferred taxes of $14	—	—	(23)
Net unrealized gain (loss) on available for sale debt securities of:			
2015 - ($1,852), net of deferred taxes of ($685) and reclassification adjustment for net realized gains included in net income of $1,444	(1,167)	—	—
2014 - $7,037, net of deferred taxes of $2,604 and reclassification adjustment for net realized gains included in net income of $213	—	4,433	—
2013 - ($8,527), net of deferred taxes of ($3,155) and reclassification adjustment for net realized gains included in net income of $240	—	—	(5,372)
Total comprehensive income	$13,574	$13,449	$3,179

See Notes to Consolidated Financial Statements

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Consolidated Statements of Shareholders' Equity
For the Years Ended December 31, 2015, 2014 and 2013

Dollars in thousands (except per share amounts)	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2012	$3,519	$5,807	$24,520	$—	$69,841	$4,868	$108,555
Comprehensive income:							
Net income	—	—	—	—	8,068	—	8,068
Other comprehensive income (loss)						(4,889)	(4,889)
Total comprehensive income							3,179
Exercise of stock options	—	—	111	—	—	—	111
Stock compensation expense	—	—	2	—	—	—	2
Conversion of Series 2011 Preferred Stock to common stock	—	(31)	31	—	—	—	—
Series 2009 Preferred Stock cash dividends declared ($80.00 per share)	—	—	—	—	(297)	—	(297)
Series 2011 Preferred Stock cash dividends declared ($40.00 per share)	—	—	—	—	(478)	—	(478)
Balance, December 31, 2013	3,519	5,776	24,664	—	77,134	(21)	111,072
Comprehensive income:							
Net income	—	—	—	—	11,356	—	11,356
Other comprehensive income						2,093	2,093
Total comprehensive income							13,449
Exercise of stock options	—	—	71	—	—	—	71
Stock compensation expense	—	—	1	—	—	—	1
Conversion of Series 2009 Preferred Stock to common stock	(100)	—	100	—	—	—	—
Conversion of Series 2011 Preferred Stock to common stock	—	(12)	12	—	—	—	—
Series 2009 Preferred Stock cash dividends declared ($80.00 per share)	—	—	—	—	(295)	—	(295)
Series 2011 Preferred Stock cash dividends declared ($40.00 per share)	—	—	—	—	(476)	—	(476)
Issuance of 819,384 shares of common stock	—	—	7,822	—	—	—	7,822
Balance, December 31, 2014	3,419	5,764	32,670	—	87,719	2,072	131,644
Comprehensive income:							
Net income	—	—	—	—	16,102	—	16,102
						(2,528)	(2,528)

Other comprehensive income (loss)							
Total comprehensive income							13,574
Exercise of stock options	—	—	51	—	—	—	51
Stock compensation expense	—	—	151	—	—	—	151
Conversion of Series 2009 Preferred Stock to common stock	(3,419)	—	3,404	—	—	—	(15)
Conversion of Series 2011 Preferred Stock to common stock	—	(5,764)	5,747	—	—	—	(17)
Issuance of 499,665 shares of common stock	—	—	4,772	—	—	—	4,772
Purchase of 208,333 shares of unallocated common stock held by ESOP	—	—	—	(2,250)	—	—	(2,250)
Allocation of 26,511 shares of common stock held by ESOP	—	—	26	286	—	—	312
Repurchase and retirement of 100,000 shares of common stock	—	—	(1,080)	—	—	—	(1,080)
Common stock cash dividends declared ($0.32 per share)	—	—	—	—	(3,398)	—	(3,398)
Balance, December 31, 2015	$—	$—	$45,741	$(1,964)	$100,423	$(456)	$143,744

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

	For the Year Ended December 31,		
Dollars in thousands	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$16,102	$11,356	$8,068
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	1,076	1,074	1,161
Provision for loan losses	1,250	2,250	4,500
Stock compensation expense	151	1	2
Deferred income tax expense	190	1,004	1,786
Loans originated for sale	(4,762)	(2,663)	(8,754)
Proceeds from loans sold	4,510	2,457	8,660
Securities gains	(1,444)	(213)	(240)
Other-than-temporary impairment of securities	—	1	118
Loss (gain) on disposal of assets	(24)	815	501
Write-downs of foreclosed properties	2,415	3,771	3,722
Amortization of securities premiums (accretion of discounts), net	5,143	5,279	6,032
Amortization of intangibles, net	200	262	363
(Increase) decrease in accrued interest receivable	293	(169)	(48)
Increase in cash surrender value of bank owned life insurance	(1,032)	(1,088)	(1,058)
(Increase) decrease in other assets	(1,077)	(55)	2,494
Increase in other liabilities	657	1,520	860
Net cash provided by operating activities	23,648	25,602	28,167
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities and calls of securities available for sale	2,043	4,051	2,669
Proceeds from sales of securities available for sale	69,632	80,914	54,340
Principal payments received on securities available for sale	38,502	34,390	62,179
Purchases of securities available for sale	(113,677)	(111,438)	(137,755)
Purchases of other investments	(9,997)	(3,899)	(2,960)
Proceeds from sales & redemptions of other investments	7,231	5,532	6,531
Net loans made to customers	(63,359)	(87,983)	(16,225)
Purchases of premises and equipment	(2,588)	(511)	(677)
Proceeds from disposal of premises and equipment	—	9	37
Proceeds from sale of repossessed assets & property held for sale	13,224	14,602	10,654
Purchases of life insurance contracts	—	—	(5,000)
Net cash used in investing activities	(58,989)	(64,333)	(26,207)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposit, NOW and savings accounts	28,487	100,174	3,524
Net decrease in time deposits	(23,125)	(42,672)	(26,837)
Net increase in short-term borrowings	47,761	60,865	58,810
Net proceeds from long-term borrowings	—	—	3,454
Repayment of long-term borrowings	(1,909)	(86,027)	(43,251)
Repayment of subordinated debt	(16,800)	—	—
Net proceeds from issuance of common stock	4,704	7,822	—
Repurchase and retirement of common stock	(1,080)	—	—
Purchase of unallocated common stock held by ESOP	(2,250)	—	—
Exercise of stock options	51	71	96
Dividends paid on common stock, net of reinvestment	(3,330)	—	—
Dividends paid on preferred stock	(191)	(774)	(776)

Net cash provided by (used in) financing activities	32,318	39,459	(4,980)
Increase (decrease) in cash and cash equivalents	(3,023)	728	(3,020)
Cash and cash equivalents:			
Beginning	12,510	11,782	14,802
Ending	$9,487	$12,510	$11,782

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows - continued

	For the Year Ended December 31,		
Dollars in thousands	2015	2014	2013
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash payments for:			
Interest	$12,854	$15,862	$18,920
Income taxes	$7,440	$2,843	$1,118
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES			
Real property and other assets acquired in settlement of loans	$2,622	$2,961	$11,823

See Notes to Consolidated Financial Statements

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NOTE 1. BASIS OF PRESENTATION

We are a financial holding company headquartered in Moorefield, West Virginia. Our primary business is community banking. Our community bank subsidiary, Summit Community Bank ("Summit Community") provides commercial and retail banking services primarily in the Eastern Panhandle and South Central regions of West Virginia and the Shenandoah Valley and Northern region of Virginia. We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia.

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Use of estimates: We must make estimates and assumptions that affect the reported amounts and disclosures in preparing our financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Summit and its subsidiaries. All significant accounts and transactions among these entities have been eliminated.

Variable interest entities: In accordance with ASC Topic 810, Consolidation, business enterprises that represent the primary beneficiary of another entity by retaining a controlling interest in that entity's assets, liabilities and results of operations must consolidate that entity in its financial statements. Prior to the issuance of ASC Topic 810, consolidation generally occurred when an enterprise controlled another entity through voting interests. If applicable, transition rules allow the restatement of financial statements or prospective application with a cumulative effect adjustment. We have determined that the provisions of ASC Topic 810 do not require consolidation of subsidiary trusts which issue guaranteed preferred beneficial interests in subordinated debentures (Trust Preferred Securities). The Trust Preferred Securities continue to qualify as Tier 1 capital for regulatory purposes. The banking regulatory agencies have not issued any guidance which would change the regulatory capital treatment for the Trust Preferred Securities based on the adoption of ASC Topic 810. The adoption of the provisions of ASC Topic 810 has had no material impact on our results of operations, financial condition, or liquidity. See Note 11 of our Notes to Consolidated Financial Statements for a discussion of our subordinated debentures owed to unconsolidated subsidiary trusts.

Cash and cash equivalents: Cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in process of clearing), and federal funds sold.

Presentation of cash flows: For purposes of reporting cash flows, cash flows from demand deposits, NOW accounts, savings accounts and short-term borrowings are reported on a net basis, since their original maturities are less than three months. Cash flows from loans and certificates of deposit and other time deposits are reported net.

Advertising: Advertising costs are expensed as incurred.

Trust services: Assets held in an agency or fiduciary capacity are not our assets and are not included in the accompanying consolidated balance sheets. Trust services income is recognized on the cash basis in accordance with customary banking practice. Reporting such income on a cash basis rather than the accrual basis does not have a material effect on net income.

Reclassifications: Certain accounts in the consolidated financial statements for 2014 and 2013, as previously presented, have been reclassified to conform to current year classifications.

Significant accounting policies: The following table identifies our other significant accounting policies and the Note and page where a detailed description of each policy can be found.

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NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU 2014-1, Investments (Topic 323) - Accounting for Investments in Affordable Housing Projects revises the necessary criteria that need to be met in order for an entity to account for investments in affordable housing projects net of the provision for income taxes. It also changes the method of recognition from an effective amortization approach to a proportional amortization approach. Additional disclosures were also set forth in this update. The amendments were effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014. The amendments were required to be applied retrospectively to all periods presented, with early adoption permitted, and did not have a material impact on our consolidated financial statements.

ASU 2014-4, Receivables (Topic 310) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure clarifies that an in substance repossession or foreclosure occurs upon either the creditor obtaining legal title to the residential real estate property or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments were effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014, with early adoption permitted, but did not have a material impact on our consolidated financial statements.

ASU 2014-11, Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 was effective for us on January 1, 2015 and did not have a significant impact on our financial statements.

ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 is effective for us beginning January 1, 2016, though early adoption is permitted, and is not expected to have a significant impact on our financial statements.

ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs specifies that debt issuance costs related to a recognized liability are to be reported in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 is effective for years beginning after December 31, 2015 and is not expected to have a material impact on our financial statements.

The guidance of ASU No. 2015-03 did not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance for debt issuance costs related to line-of-credit arrangements within the update, in ASU 2015-15, Interest—Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC

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Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting), issued in August 2015, the SEC staff stated that they would not object to any entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

ASU 2015-05, Intangibles – Goodwill and Other - Internal-Use Software (Subtopic 350-40) – Customer's Accounting for Fees Paid in a Cloud Computing Arrangement addresses accounting for fees paid by a customer in cloud computing arrangements such as (i) software as a service, (ii) platform as a service, (iii) infrastructure as a service and (iv) other similar hosting arrangements. ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 will be effective for us on January 1, 2016 and is not expected to have a significant impact on our financial statements.

ASU 2015-16, Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments requires that adjustments to provisional amounts that are identified during the measurement period of a business combination be recognized in the reporting period in which the adjustment amounts are determined. Furthermore, the income statement effects of such adjustments, if any, must be calculated as if the accounting had been completed at the acquisition date reflecting the portion of the amount recorded in current-period earnings that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. Under previous guidance, adjustments to provisional amounts identified during the measurement period are to be recognized retrospectively. ASU 2015-16 will be effective for us on January 1, 2016 and is not expected to have a significant impact on our financial statements.

ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for sale, and impaired loans held

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for investment. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Certain trust preferred securities classified as corporate debt securities are Level 3 due to limited market trades of these classes of securities.

Derivative Financial Instruments: Derivative financial instruments are recorded at fair value on a recurring basis. Fair value measurement is based on pricing models run by a third-party, utilizing observable market-based inputs. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. As a result, we classify interest rate swaps as Level 2.

Loans Held for Sale: Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, we classify loans subject to nonrecurring fair value adjustments as Level 2.

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the original contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the discounted cash flows or collateral value exceeds the recorded investments in such loans. These loans are carried at recorded loan investment, and therefore are not included in the following tables of loans measured at fair value. Impaired loans internally graded as substandard, doubtful, or loss are evaluated using the fair value of collateral method. All other impaired loans are measured for impairment using the discounted cash flows method. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

When impaired loans are deemed required to be included in the fair value hierarchy, management immediately begins the process of evaluating the estimated fair value of the underlying collateral to determine if a related specific allowance for loan losses or charge-off is necessary. Current appraisals are ordered once a loan is deemed impaired if the existing appraisal is more than twelve months old, or more frequently if there is known deterioration in value. For recently identified impaired loans, a current appraisal may not be available at the financial statement date. Until the current appraisal is obtained, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the loan's underlying collateral since the date of the original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar collateral within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends. When a new appraisal is received (which generally are received within 3 months of a loan being identified as impaired), management then re-evaluates the fair value of the collateral and adjusts any specific allocated allowance for loan losses, as appropriate. In addition, management also assigns a discount of 7–10% for the estimated costs to sell the collateral.

Foreclosed Properties: Foreclosed properties consists of real estate acquired in foreclosure or other settlement of loans. Such assets are carried on the balance sheet at the lower of the investment in the real estate or its fair value less estimated selling costs. The fair value of foreclosed properties is determined on a nonrecurring basis generally utilizing current appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data (Level 2). Updated appraisals of foreclosed properties are generally obtained if the existing appraisal is more than 18 months old or more frequently if there is a known deterioration in value. However, if a current appraisal is not available, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the real estate since the date of its original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar property within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends (Level 3). Upon foreclosure, any fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest expense in the consolidated statements of income.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

	Balance at	Fair Value Measurements Using:		
Dollars in thousands	December 31, 2015	Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$21,475	$—	$21,475	$—
Mortgage backed securities:				
Government sponsored agencies	146,734	—	146,734	—
Nongovernment sponsored entities	7,885	—	7,885	—
State and political subdivisions	1,953	—	1,953	—
Corporate debt securities	14,226	—	8,367	5,859
Other equity securities	77	—	77	—
Tax-exempt state and political subdivisions	88,442	—	88,442	—
Total available for sale securities	$280,792	$—	$274,933	$5,859
Derivative financial liabilities				
Interest rate swaps	$5,072	$—	$5,072	$—

	Balance at	Fair Value Measurements Using:		
Dollars in thousands	December 31, 2014	Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$23,174	$—	$23,174	$—
Mortgage backed securities:				
Government sponsored agencies	149,777	—	149,777	—
Nongovernment sponsored entities	12,145	—	12,145	—
State and political subdivisions	8,694	—	8,694	—
Corporate debt securities	3,776	—	—	3,776
Other equity securities	7	—	7	—
Tax-exempt state and political subdivisions	85,261	—	85,261	—
Total available for sale securities	$282,834	$—	$279,058	$3,776
Derivative financial assets				
Interest rate swaps	$2,911	$—	$2,911	$—

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable (Level 3) inputs is not presented as such amounts were not significant during the reported periods.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

Dollars in thousands	Balance at December 31, 2015	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$779	$—	$779	$—
Collateral-dependent impaired loans				
Commercial	$—	$—	$—	$—
Commercial real estate	627	—	—	627
Construction and development	1,054	—	—	1,054
Residential real estate	279	—	279	—
Total collateral-dependent impaired loans	$1,960	$—	$279	$1,681
Foreclosed properties				
Commercial real estate	$1,103	$—	$1,103	$—
Construction and development	18,477	—	18,419	58
Residential real estate	314	—	314	—
Total foreclosed properties	$19,894	$—	$19,836	$58

Dollars in thousands	Balance at December 31, 2014	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$527	$—	$527	$—
Collateral-dependent impaired loans				
Commercial	$44	—	$—	$44
Commercial real estate	344	—	344	—
Construction and development	852	—	852	—
Residential real estate	312	—	312	—
Total collateral-dependent impaired loans	$1,552	$—	$1,508	$44
Foreclosed properties				
Commercial real estate	$3,892	$—	$3,892	$—
Construction and development	20,952	—	20,841	111
Residential real estate	2,025	—	2,025	—
Total foreclosed properties	$26,869	$—	$26,758	$111

ASC Topic 825, Financial Instruments, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The following summarizes the methods and significant assumptions we used in estimating our fair value disclosures for financial instruments.

Cash and cash equivalents: The carrying values of cash and cash equivalents approximate their estimated fair value.

Interest bearing deposits with other banks: The carrying values of interest bearing deposits with other banks approximate their estimated fair values.

Federal funds sold: The carrying values of Federal funds sold approximate their estimated fair values.

Securities: Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Loans held for sale: The carrying values of loans held for sale approximate their estimated fair values.

Loans: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

Accrued interest receivable and payable: The carrying values of accrued interest receivable and payable approximate their estimated fair values.

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Deposits: The estimated fair values of demand deposits (i.e. non-interest bearing checking, NOW, money market and savings accounts) and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

Short-term borrowings: The carrying values of short-term borrowings approximate their estimated fair values.

Long-term borrowings: The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

Subordinated debentures: The carrying values of subordinated debentures approximate their estimated fair values.

Subordinated debentures owed to unconsolidated subsidiary trusts: The carrying values of subordinated debentures owed to unconsolidated subsidiary trusts approximate their estimated fair values.

Derivative financial instruments: The fair value of the interest rate swaps is valued using independent pricing models.

Off-balance sheet instruments: The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counter parties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

The carrying values and estimated fair values of our financial instruments are summarized below:

	At December 31,			
	2015		2014	
Dollars in thousands	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$9,487	$9,487	$12,510	$12,510
Securities available for sale	280,792	280,792	282,834	282,834
Other investments	8,949	8,949	6,183	6,183
Loans held for sale, net	779	779	527	527
Loans, net	1,079,331	1,084,955	1,019,842	1,033,890
Accrued interest receivable	5,544	5,544	5,838	5,838
	$1,384,882	$1,390,506	$1,327,734	$1,341,782
Financial liabilities				
Deposits	$1,066,709	$1,077,510	$1,061,314	$1,078,406
Short-term borrowings	171,394	171,394	123,633	123,633
Long-term borrowings	75,581	80,506	77,490	84,732
Subordinated debentures	—	—	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	826	826	812	812
Derivative financial liabilities	5,072	5,072	2,911	2,911
	$1,339,171	$1,354,897	$1,302,549	$1,326,883

NOTE 4. SECURITIES

We classify debt and equity securities as “held to maturity”, “available for sale” or “trading” according to management’s intent. The appropriate classification is determined at the time of purchase of each security and re-evaluated at each reporting date.

Securities held to maturity: Certain debt securities for which we have the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts. There are no securities classified as held to maturity in the accompanying financial statements.

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Securities available for sale: Securities not classified as "held to maturity" or as "trading" are classified as "available for sale." Securities classified as "available for sale" are those securities that we intend to hold for an indefinite period of time, but not necessarily to maturity. "Available for sale" securities are reported at estimated fair value net of unrealized gains or losses, which are adjusted for applicable income taxes, and reported as a separate component of shareholders' equity.

Trading securities: There are no securities classified as "trading" in the accompanying financial statements.

Impairment assessment: Impairment exists when the fair value of a security is less than its cost. Cost includes adjustments made to the cost basis of a security for accretion, amortization and previous other-than-temporary impairments. We perform a quarterly assessment of the debt and equity securities in our investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. This determination requires significant judgment. Impairment is considered other-than-temporary when it becomes probable that we will be unable to recover the cost of an investment. This assessment takes into consideration factors such as the length of time and the extent to which the market values have been less than cost, the financial condition and near term prospects of the issuer including events specific to the issuer or industry, defaults or deferrals of scheduled interest, principal or dividend payments, external credit ratings and recent downgrades, and our intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The amount of the write down is included in other-than-temporary impairment of securities in the consolidated statements of income. The new cost basis is not adjusted for subsequent recoveries in fair value, if any.

Realized gains and losses on sales of securities are recognized on the specific identification method. Amortization of premiums and accretion of discounts are computed using the interest method.

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at December 31, 2015 and 2014, are summarized as follows:

	December 31, 2015			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$20,461	$1,063	$49	$21,475
Residential mortgage-backed securities:				
Government-sponsored agencies	145,586	1,943	795	146,734
Nongovernment-sponsored entities	7,836	82	33	7,885
State and political subdivisions				
Water and sewer revenues	250	—	—	250
Other revenues	1,729	—	26	1,703
Corporate debt securities	14,494	—	268	14,226
Total taxable debt securities	190,356	3,088	1,171	192,273
Tax-exempt debt securities				
State and political subdivisions				
General obligations	52,490	1,767	41	54,216
Water and sewer revenues	7,614	172	—	7,786
Lease revenues	8,671	187	1	8,857
Special tax revenues	4,532	72	—	4,604
Other revenues	12,703	290	14	12,979
Total tax-exempt debt securities	86,010	2,488	56	88,442

Equity securities	77	—	—	77
Total available for sale securities	$276,443	$5,576	$1,227	$280,792

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	December 31, 2014			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$22,153	$1,073	$52	$23,174
Residential mortgage-backed securities:				
Government-sponsored agencies	147,951	2,599	773	149,777
Nongovernment-sponsored entities	12,051	142	48	12,145
State and political subdivisions				
General obligations	1,975	2	33	1,944
Water and sewer revenues	1,976	14	7	1,983
Other revenues	4,696	73	2	4,767
Corporate debt securities	3,776	—	—	3,776
Total taxable debt securities	194,578	3,903	915	197,566
Tax-exempt debt securities				
State and political subdivisions				
General obligations	49,515	2,338	12	51,841
Water and sewer revenues	11,258	244	3	11,499
Lease revenues	4,617	75	10	4,682
Lottery/casino revenues	3,811	206	9	4,008
Other revenues	12,845	404	18	13,231
Total tax-exempt debt securities	82,046	3,267	52	85,261
Equity securities	7	—	—	7
Total available for sale securities	$276,631	$7,170	$967	$282,834

The below information is relative to the five states where issuers with the highest volume of state and political subdivision securities held in our portfolio are located. We own no such securities of any single issuer which we deem to be a concentration.

	December 31, 2015			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Illinois	$9,899	$302	$2	$10,199
Texas	9,636	334	—	9,970
West Virginia	7,736	117	—	7,853
Ohio	7,246	114	—	7,360
California	6,139	202	15	6,326

Management performs pre-purchase and ongoing analysis to confirm that all investment securities meet applicable credit quality standards. Prior to July 1, 2013, we principally used credit ratings from Nationally Recognized Statistical Rating Organizations ("NRSROs") to support analyses of our portfolio of securities issued by state and political subdivisions, as we generally do not purchase securities that are rated below the six highest NRSRO rating categories. Beginning July 1, 2013, in addition to considering a security's NRSRO rating, we now also assess or confirm through an internal review of an issuer's financial information and other applicable information that: 1) the issuer's risk of default is low; 2) the characteristics of the issuer's demographics and economic environment are satisfactory; and 3) the issuer's budgetary position and stability of tax or other revenue sources are sound.

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized are as follows:

Dollars in thousands	Proceeds from			Gross realized	
		Calls and	Principal		
Years ended December 31,	Sales	Maturities	Payments	Gains	Losses
2015	$69,632	$2,043	$38,502	$1,732	$288
2014	80,914	4,051	34,390	1,037	824
2013	54,340	2,669	62,179	674	434

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Residential mortgage-backed obligations having contractual maturities ranging from 4 to 50 years are reflected in the following maturity distribution schedules based on their anticipated average life to maturity, which ranges from 1 to 32 years. Accordingly, discounts are accreted and premiums are amortized over the anticipated average life to maturity of the specific obligation.

The maturities, amortized cost and estimated fair values of securities at December 31, 2015, are summarized as follows:

Dollars in thousands	Amortized Cost	Estimated Fair Value
Due in one year or less	$52,801	$53,343
Due from one to five years	101,061	101,891
Due from five to ten years	21,248	21,661
Due after ten years	101,256	103,820
Equity securities	77	77
Total	$276,443	$280,792

At December 31, 2015 and 2014, securities with estimated fair values of $131.2 million and $128.1 million respectively, were pledged to secure public deposits, and for other purposes required or permitted by law.

We held 64 available for sale securities having an unrealized loss at December 31, 2015. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

Provided below is a summary of securities available for sale which were in an unrealized loss position at December 31, 2015 and 2014, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

	2015					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	$2,104	$(2)	$3,151	$(47)	$5,255	$(49)
Residential mortgage-backed securities:						
Government-sponsored agencies	52,970	(569)	8,672	(226)	61,642	(795)
Nongovernment-sponsored entities	2,298	—	2,819	(33)	5,117	(33)
State and political subdivisions:						
Other revenues	1,702	(26)	—	—	1,702	(26)
Corporate debt securities	8,367	(268)	—	—	8,367	(268)
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	5,977	(41)	—	—	5,977	(41)
Lease revenues	576	(1)	—	—	576	(1)
Other revenues	1,218	(14)	—	—	1,218	(14)

Total temporarily impaired securities	75,212	(921	)	14,642	(306	)	89,854	(1,227	)
Total other-than-temporarily impaired securities	—	—		—	—		—	—	
Total	$75,212	$(921	)	$14,642	$(306	)	$89,854	$(1,227	)

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Dollars in thousands	2014 Less than 12 months Estimated Fair Value	Unrealized Loss	12 months or more Estimated Fair Value	Unrealized Loss	Total Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	$—	$—	$3,912	$(52)	$3,912	$(52)
Residential mortgage-backed securities:						
Government-sponsored agencies	36,825	(535)	21,915	(238)	58,740	(773)
Nongovernment-sponsored entities	5,488	(44)	2,163	(4)	7,651	(48)
State and political subdivisions:						
General obligations	—	—	316	(33)	316	(33)
Water and sewer revenues	—	—	817	(7)	817	(7)
Other revenues	1,098	(2)	—	—	1,098	(2)
Corporate debt securities	—	—	—	—	—	—
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	3,708	(8)	438	(4)	4,146	(12)
Water and sewer revenues	721	(3)	—	—	721	(3)
Lease revenues	—	—	1,168	(10)	1,168	(10)
Lottery/casino revenues	—	—	1,126	(9)	1,126	(9)
Other revenues	1,247	(8)	846	(10)	2,093	(18)
Total temporarily impaired securities	49,087	(600)	32,701	(367)	81,788	(967)
Total other-than-temporarily impaired securities	—	—	—	—	—	—
Total	$49,087	$(600)	$32,701	$(367)	$81,788	$(967)

NOTE 5. LOANS

Loans are generally stated at the amount of unpaid principal, reduced by unearned discount and allowance for loan losses. Interest on loans is accrued daily on the outstanding balances. Loan origination fees and certain direct loan origination costs are deferred and amortized as adjustments of the related loan yield over its contractual life. We categorize residential real estate loans in excess of $600,000 as jumbo loans.

Generally, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or, if applicable, the terms of the restructured loans.

Commercial-related loans or portions thereof (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination is made on a case by case basis considering many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower’s equity. We deem a loss confirmed when a loan or a portion of a loan is classified “loss” in accordance with bank regulatory classification guidelines, which state, “Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted”.

Consumer-related loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), which ever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Loans are summarized as follows:

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Dollars in thousands	2015	2014
Commercial	$97,201	$88,590
Commercial real estate		
Owner-occupied	203,555	157,783
Non-owner occupied	337,294	317,136
Construction and development		
Land and land development	65,500	67,881
Construction	9,970	28,591
Residential real estate		
Non-jumbo	221,750	220,071
Jumbo	50,313	52,879
Home equity	74,300	67,115
Consumer	19,251	19,456
Other	11,669	11,507
Total loans, net of unearned fees	1,090,803	1,031,009
Less allowance for loan losses	11,472	11,167
Loans, net	$1,079,331	$1,019,842

The following presents loan maturities at December 31, 2015:

Dollars in thousands	Within 1 Year	After 1 but within 5 Years	After 5 Years
Commercial	$39,542	$39,968	$17,691
Commercial real estate	16,623	56,690	467,536
Construction and development	35,419	8,811	31,239
Residential real estate	7,669	15,344	323,350
Consumer	3,893	12,522	2,836
Other	669	1,312	9,689
	$103,815	$134,647	$852,341
Loans due after one year with:			
Variable rates		$138,002	
Fixed rates		848,986	
		$986,988	

The following table presents the contractual aging of the recorded investment in past due loans by class as of December 31, 2015 and 2014.

	At December 31, 2015					
	Past Due					> 90 days and Accruing
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	
Commercial	$345	$26	$632	$1,003	$96,198	$—
Commercial real estate						
Owner-occupied	158	386	437	981	202,574	—
Non-owner occupied	1	—	856	857	336,437	—
Construction and development						
Land and land development	1,182	194	4,547	5,923	59,577	—
Construction	—	—	—	—	9,970	—
Residential mortgage						
Non-jumbo	2,276	2,647	1,591	6,514	215,236	—
Jumbo	—	—	—	—	50,313	—
Home equity	374	172	100	646	73,654	—

Consumer	155	41	92	288	18,963	9
Other	—	—	—	—	11,669	—
Total	$4,491	$3,466	$8,255	$16,212	$1,074,591	$9

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	At December 31, 2014					
	Past Due					
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	> 90 days and Accruing
Commercial	$328	$117	$330	$775	$87,815	$—
Commercial real estate						
Owner-occupied	121	194	801	1,116	156,667	—
Non-owner occupied	146	—	406	552	316,584	—
Construction and development						
Land and land development	346	2,002	4,253	6,601	61,280	—
Construction	—	—	—	—	28,591	—
Residential mortgage						
Non-jumbo	4,104	2,719	1,498	8,321	211,750	—
Jumbo	—	—	2,626	2,626	50,253	—
Home equity	1,067	94	83	1,244	65,871	—
Consumer	260	42	63	365	19,091	—
Other	—	—	—	—	11,507	—
Total	$6,372	$5,168	$10,060	$21,600	$1,009,409	$—

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at December 31, 2015 and 2014.

Dollars in thousands	2015	2014
Commercial	$853	$392
Commercial real estate		
Owner-occupied	437	1,218
Non-owner occupied	5,518	626
Construction and development		
Land & land development	5,623	4,619
Construction	—	—
Residential mortgage		
Non-jumbo	2,987	2,663
Jumbo	—	2,626
Home equity	258	267
Consumer	83	83
Total	$15,759	$12,494

Impaired loans: Impaired loans include the following:

Loans which we risk-rate (consisting of loan relationships having aggregate balances in excess of $2.0 million, or loans exceeding $500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

Loans that have been modified in a troubled debt restructuring.

Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring. Troubled debt restructurings typically result from our loss mitigation activities and occur when we grant a concession to a borrower who is experiencing financial difficulty in order to minimize our economic loss and to avoid foreclosure or repossession of collateral. Once restructured in a troubled debt restructuring, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if the criteria set forth in our accounting policy are met, the loan would continue to be evaluated for an asset-specific allowance for loan losses and we would continue to report the loan in the impaired loan table below.

The table below sets forth information about our impaired loans.

Method Used to Measure Impairment of Impaired Loans
Dollars in thousands

	December 31,		Method used to measure
Loan Category	2015	2014	impairment
Commercial	$41	$132	Fair value of collateral
	201	362	Discounted cash flow
Commercial real estate			
Owner-occupied	783	1,683	Fair value of collateral
	7,616	9,124	Discounted cash flow
Non-owner occupied	5,728	508	Fair value of collateral
	7,722	5,999	Discounted cash flow
Construction and development			
Land & land development	6,597	11,998	Fair value of collateral
	2,177	2,310	Discounted cash flow
Residential mortgage			
Non-jumbo	1,753	1,676	Fair value of collateral
	4,378	5,252	Discounted cash flow
Jumbo	3,869	7,594	Fair value of collateral
	871	886	Discounted cash flow
Home equity	186	285	Fair value of collateral
	523	523	Discounted cash flow
Consumer	—	2	Fair value of collateral
	68	82	Discounted cash flow
Total	$42,513	$48,416	

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The following tables present loans individually evaluated for impairment at December 31, 2015 and 2014.

	December 31, 2015				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$242	$242	$—	$319	$17
Commercial real estate					
Owner-occupied	5,401	5,402	—	5,438	191
Non-owner occupied	10,740	10,741	—	9,982	310
Construction and development					
Land & land development	7,635	7,635	—	9,497	263
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,590	3,600	—	3,316	160
Jumbo	3,871	3,869	—	4,412	181
Home equity	709	709	—	709	32
Consumer	68	68	—	72	6
Total without a related allowance	$32,256	$32,266	$—	$33,745	$1,160
With a related allowance					
Commercial	$—	$—	$—	$—	$—
Commercial real estate					
Owner-occupied	2,997	2,997	45	3,003	135
Non-owner occupied	2,709	2,709	386	2,728	72
Construction and development					
Land & land development	1,139	1,139	85	1,154	—
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,530	2,531	226	2,552	114
Jumbo	871	871	34	878	43
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$10,246	$10,247	$776	$10,315	$364
Total					
Commercial	$30,863	$30,865	$516	$32,121	$988
Residential real estate	11,571	11,580	260	11,867	530
Consumer	68	68	—	72	6
Total	$42,502	$42,513	$776	$44,060	$1,524

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	December 31, 2014				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$370	$369	$—	$430	$27
Commercial real estate					
Owner-occupied	5,362	5,361	—	5,309	192
Non-owner occupied	3,645	3,647	—	4,420	199
Construction and development					
Land & land development	13,410	13,410	—	14,149	483
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	4,289	4,300	—	3,853	185
Jumbo	7,589	7,594	—	7,761	241
Home equity	809	808	—	265	14
Consumer	84	84	—	36	2
Total without a related allowance	$35,558	$35,573	$—	$36,223	$1,343
With a related allowance					
Commercial	$125	$125	$81	$38	$—
Commercial real estate					
Owner-occupied	5,446	5,446	287	5,461	216
Non-owner occupied	2,860	2,860	74	1,003	40
Construction and development					
Land & land development	898	898	46	933	42
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,627	2,628	282	2,093	98
Jumbo	885	886	46	892	45
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$12,841	$12,843	$816	$10,420	$441
Total					
Commercial	$32,116	$32,116	$488	$31,743	$1,199
Residential real estate	16,199	16,216	328	14,864	583
Consumer	84	84	—	36	2
Total	$48,399	$48,416	$816	$46,643	$1,784

The average recorded investment of impaired loans during 2013 was $56.9 million, and $2.0 million interest income was recognized on those loans while impaired.

A modification of a loan is considered a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of both. A loan continues to be classified as a TDR for the life of the loan. Included in impaired loans are TDRs of $30.5 million, of which $28.9 million were current with respect to restructured contractual payments at December 31, 2015, and $34.7 million, of which $32.2 million were current with respect to restructured contractual payments at December 31, 2014. There were no commitments to lend additional funds under these restructurings at either balance sheet date.

The following table presents by class the TDRs that were restructured during 2015 and 2014. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

Dollars in thousands	2015 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment	2014 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment
Commercial	—	$ —	$ —	3	$ 82	$ 86
Commercial real estate						
Non-owner occupied	—	—	—	1	2,154	2,154
Construction and development						
Land & land development	1	1,182	1,182	—	—	—
Residential real estate						
Non-jumbo	1	25	25	5	1,044	1,080
Home equity	—	—	—	1	411	523
Consumer	1	2	2	1	18	18
Total	3	$ 1,209	$ 1,209	11	$ 3,709	$ 3,861

The following table presents defaults during the stated period of TDRs that were restructured during the past twelve months. For purposes of these tables, a default is considered as either the loan was past due 30 days or more at any time during the period, or the loan was fully or partially charged off during the period.

Dollars in thousands	2015 Number of Defaults	Recorded Investment at Default Date	2014 Number of Defaults	Recorded Investment at Default Date
Commercial	—	$—	3	$86
Construction and development				
Land & land development	1	1,182	—	—
Residential real estate				
Non-jumbo	—	—	1	167
Total	1	$1,182	4	$253

The following table details the activity regarding TDRs by loan type during 2015, and the related allowance on TDRs.

2015

	Construction & Land Development			Commercial Real Estate		Residential Real Estate					
Dollars in thousands	Land & Land Develop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Con-sumer	Other	Total
Troubled debt restructurings											
Balance January 1, 2015	$5,786	$—	$410	$9,501	$6,219	$6,245	$5,937	$523	$85	$—	$34,706
Additions	1,182	—	—	—	—	25	—	—	2	—	1,209
Charge-offs	(168)	—	—	—	—	—	—	—	—	—	(168)
Net (paydowns) advances	(2,611)	—	(168)	(187)	(160)	(774)	(1,302)	—	(20)	—	(5,222)
	—	—	—	—	—	—	—	—	—	—	—

Transfer into foreclosed properties											
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—
Balance, December 31, 2015	$4,189	$—	$242	$9,314	$6,059	$5,496	$4,635	$523	$67	$—	$30,525
Allowance related to troubled debt restructurings	$—	$—	$—	$190	$12	$226	$35	$—	$—	$—	$463

We categorize loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk. We internally

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grade all commercial loans at the time of loan origination. In addition, we perform an annual loan review on all non-homogenous commercial loan relationships with an aggregate exposure of $2 million, at which time these loans are re-graded. We use the following definitions for our risk grades:

Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

OLEM (Special Mention): Commercial loans categorized as OLEM are potentially weak. The credit risk may be relatively minor yet represent a risk given certain specific circumstances. If the potential weaknesses are not monitored or mitigated, the asset may weaken or inadequately protect our position in the future.

Substandard: Commercial loans categorized as Substandard are inadequately protected by the borrower's ability to repay, equity, and/or the collateral pledged to secure the loan. These loans have identified weaknesses that could hinder normal repayment or collection of the debt. These loans are characterized by the distinct possibility that we will sustain some loss if the identified weaknesses are not mitigated.

Doubtful: Commercial loans categorized as Doubtful have all the weaknesses inherent in those loans classified as Substandard, with the added elements that the full collection of the loan is improbable and the possibility of loss is high.

Loss: Loans classified as loss are considered to be non-collectible and of such little value that their continuance as a bankable asset is not warranted. This does not mean that the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future.

The following table presents the recorded investment in construction and development, commercial, and commercial real estate loans which are generally evaluated based upon the internal risk ratings defined above.

Loan Risk Profile by Internal Risk Rating

	Construction and Development						Commercial Real Estate			
	Land and Land Development		Construction		Commercial		Owner Occupied		Non-Owner Occupied	
Dollars in thousands	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014
Pass	$57,155	$53,873	$9,970	$28,591	$95,174	$86,361	$202,226	$155,189	$329,861	$306,710
OLEM (Special Mention)	1,598	1,673	—	—	1,295	1,837	546	1,064	1,602	8,933
Substandard	6,747	12,335	—	—	732	392	783	1,530	5,831	1,493
Doubtful	—	—	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—	—	—	—
Total	$65,500	$67,881	$9,970	$28,591	$97,201	$88,590	$203,555	$157,783	$337,294	$317,136

The following table presents the recorded investment in consumer, residential real estate, and home equity loans, which are generally evaluated based on the aging status of the loans, which was previously presented, and payment activity.

	Performing		Nonperforming	
Dollars in thousands	2015	2014	2015	2014
Residential real estate				
Non-jumbo	$218,763	$217,408	$2,987	$2,663
Jumbo	50,313	50,253	—	2,626

Home Equity	74,042	66,848	258	267
Consumer	19,149	19,373	102	83
Other	11,669	11,507	—	—
Total	$373,936	$365,389	$3,347	$5,639

Industry concentrations: At December 31, 2015 and 2014, we had no concentrations of loans to any single industry in excess of 10% of total loans.

Loans to related parties: We have had, and may be expected to have in the future, banking transactions in the ordinary course of business with our directors, principal officers, their immediate families and affiliated companies in which they are principal

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shareholders (commonly referred to as related parties). These transactions have been, in our opinion, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

The following presents the activity with respect to related party loans aggregating $60,000 or more to any one related party (other changes represent additions to and changes in director and executive officer status):

Dollars in thousands	2015	2014
Balance, beginning	$20,586	$18,577
Additions	11,095	13,842
Amounts collected	(6,142)	(11,833)
Other changes, net	(2,565)	—
Balance, ending	$22,974	$20,586

Loan commitments: ASC Topic 815, Derivatives and Hedging, requires that commitments to make mortgage loans should be accounted for as derivatives if the loans are to be held for sale, because the commitment represents a written option and accordingly is recorded at the fair value of the option liability.

NOTE 6. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level considered adequate to provide for our estimate of probable credit losses inherent in the loan portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Loans are charged against the allowance for loan losses when we believe that collectability is unlikely. While we use the best information available to make our evaluation, future adjustments may be necessary if there are significant changes in conditions.

The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology we employ on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is as follows.

Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of $500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans historically have been collateral dependent, meaning repayment of the loan is expected or is considered to be provided solely from the sale of the loan’s underlying collateral. For such loans, we measure impairment based on the fair value of the loan’s collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known deterioration in the collateral’s value, in which case a new appraisal is obtained. Beginning in 2014, for purposes of loans that have been modified in a troubled debt restructuring and not internally graded as substandard, doubtful, or loss ("performing TDRs") we began measuring impairment using the discounted cash flows method. Under this method, a specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over its discounted cash flows.

Quantitative Reserve for Loans Collectively Evaluated

Second, we stratify the loan portfolio into the following ten loan pools: land and land development, construction, commercial, commercial real estate - owner occupied, commercial real estate - non-owner occupied, conventional residential mortgage, jumbo residential mortgage, home equity, consumer, and other. Quantitative reserves relative to each loan pool are established as follows: for all loan segments detailed above an allocation equaling 100% of the respective pool's average 12 month historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the pool of loans.

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Qualitative Reserve for Loans Collectively Evaluated

Third, we consider the necessity to adjust our average historical net loan charge-off rates relative to each of the above ten loan pools for potential risks factors that could result in actual losses deviating from prior loss experience. For example, if we observe a significant increase in delinquencies within the conventional mortgage loan pool above historical trends, an additional allocation to the average historical loan charge-off rate is applied. Such qualitative risk factors considered are: (1) levels of and trends in delinquencies and impaired loans, (2) levels of and trends in charge-offs and recoveries, (3) trends in volume and term of loans, (4) effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practice, (5) experience, ability, and depth of lending management and other relevant staff, (6) national and local economic trends and conditions, (7) industry conditions, and (8) effects of changes in credit concentrations.

An analysis of the allowance for loan losses for the years ended December 31, 2015, 2014, and 2013 is as follows:

Dollars in thousands	2015	2014	2013
Balance, beginning of year	$11,167	$12,659	$17,933
Losses:			
Commercial	77	390	723
Commercial real estate			
Owner occupied	559	11	1,031
Non-owner occupied	178	—	9
Construction and development			
Land and land development	457	3,535	3,596
Construction	—	—	—
Residential real estate			
Non-jumbo	417	435	541
Jumbo	208	65	4,741
Home equity	76	14	77
Consumer	69	265	79
Other	110	118	162
Total	2,151	4,833	10,959
Recoveries:			
Commercial	10	34	12
Commercial real estate			
Owner occupied	290	40	8
Non-owner occupied	13	318	674
Construction and development			
Land and land development	456	298	187
Construction	—	—	—
Real estate - mortgage			
Non-jumbo	107	87	127
Jumbo	96	163	6
Home equity	3	4	5
Consumer	105	74	79
Other	126	73	87
Total	1,206	1,091	1,185
Net losses	945	3,742	9,774
Provision for loan losses	1,250	2,250	4,500
Balance, end of year	$11,472	$11,167	$12,659

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Activity in the allowance for loan losses by loan class during 2015 and 2014 is as follows:

2015

	Construction & Land Development		Commercial Real Estate			Residential Real Estate					
Dollars in thousands	Land & Land Develop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Con-sumer	Other	Total
Allowance for loan losses											
Beginning balance	$3,417	$427	$1,204	$927	$1,316	$1,280	$2,081	$187	$97	$231	$11,167
Charge-offs	457	—	77	559	178	417	208	76	69	110	2,151
Recoveries	456	—	10	290	13	107	96	3	105	126	1,206
Provision	(564)	(412)	(356)	931	1,826	283	(376)	139	(74)	(147)	1,250
Ending balance	$2,852	$15	$781	$1,589	$2,977	$1,253	$1,593	$253	$59	$100	$11,472
Allowance related to:											
Loans individually evaluated for impairment	$85	$—	$—	$45	$386	$225	$35	$—	$—	$—	$776
Loans collectively evaluated for impairment	2,767	15	781	1,544	2,591	1,028	1,558	253	59	100	10,696
Total	$2,852	$15	$781	$1,589	$2,977	$1,253	$1,593	$253	$59	$100	$11,472
Loans											
Loans individually evaluated for impairment	$8,774	$—	$242	$8,399	$13,450	$6,131	$4,740	$709	$68	$—	$42,513
Loans collectively evaluated for impairment	56,726	9,970	96,959	195,156	323,844	215,619	45,573	73,591	19,183	11,669	$1,048,290
Total	$65,500	$9,970	$97,201	$203,555	$337,294	$221,750	$50,313	$74,300	$19,251	$11,669	$1,090,803

2014

	Construction & Land Development		Commercial Real Estate			Residential Real Estate					
Dollars in thousands	Land & Land	Construc-tion	Commer-cial	Owner Occupied	Non-Owner	Non-jumbo	Jumbo	Home Equity	Con-sumer	Other	Total

	Develop-ment				Occupied						
Allowance for loan losses											
Beginning balance	$5,455	$269	$1,324	$969	$641	$1,842	$1,888	$173	$47	$51	$12,659
Charge-offs	3,535	—	390	11	—	435	65	14	265	118	4,833
Recoveries	298	—	34	40	318	87	163	4	74	73	1,091
Provision	1,199	158	236	(71)	357	(214)	95	24	241	225	2,250
Ending balance	$3,417	$427	$1,204	$927	$1,316	$1,280	$2,081	$187	$97	$231	$11,167
Allowance related to:											
Loans individually evaluated for impairment	$46	$—	$81	$286	$74	$282	$46	$—	$—	$—	$815
Loans collectively evaluated for impairment	3,371	427	1,123	641	1,242	998	2,035	187	97	231	10,352
Total	$3,417	$427	$1,204	$927	$1,316	$1,280	$2,081	$187	$97	$231	$11,167
Loans											
Loans individually evaluated for impairment	$14,308	$—	$495	$10,807	$6,507	$6,927	$8,480	$808	$84	$—	$48,416
Loans collectively evaluated for impairment	53,573	28,591	88,095	146,976	310,629	213,144	44,399	66,307	19,372	11,507	$982,593
Total	$67,881	$28,591	$88,590	$157,783	$317,136	$220,071	$52,879	$67,115	$19,456	$11,507	$1,031,009

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NOTE 7. PROPERTY HELD FOR SALE

Property held for sale consists of premises qualifying as held for sale under ASC Topic 360 Property, Plant, and Equipment, and of real estate acquired through foreclosure on loans secured by such real estate. Qualifying premises are transferred to property held for sale at the lower of carrying value or estimated fair value less anticipated selling costs. Foreclosed property is recorded at the lower of the related loans recorded investment or estimated fair value less anticipated selling costs based upon the property’s appraised value at the date of foreclosure, with any difference between the fair value of foreclosed property and the carrying value of the related loan charged to the allowance for loan losses. We perform periodic valuations of property held for sale subsequent to transfer. Changes in value subsequent to transfer are recorded in noninterest expense. Gains or losses not previously recognized resulting from the sale of property held for sale is recognized on the date of sale and is included in noninterest expense. Depreciation is not recorded on property held for sale. Expenses incurred in connection with operating foreclosed properties are charged to noninterest expense.

The following table presents the activity of property held for sale during 2015 and 2014.

Dollars in thousands	2015	2014
Beginning balance	$37,529	$53,392
Acquisitions	2,617	2,673
Capitalized improvements	39	87
Dispositions	(12,203)	(14,852)
Valuation adjustments	(2,415)	(3,771)
Balance at year end	$25,567	$37,529

NOTE 8. PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily by the straight-line method for premises and equipment over the estimated useful lives of the assets. The estimated useful lives employed are on average 30 years for premises and 3 to 10 years for furniture and equipment. Repairs and maintenance expenditures are charged to operating expenses as incurred. Major improvements and additions to premises and equipment, including construction period interest costs, are capitalized. No interest was capitalized during 2015, 2014, or 2013.

The major categories of premises and equipment and accumulated depreciation at December 31, 2015 and 2014 are summarized as follows:

Dollars in thousands	2015	2014
Land	$6,308	$6,308
Buildings and improvements	21,461	20,202
Furniture and equipment	14,552	13,223
	42,321	39,733
Less accumulated depreciation	20,749	19,673
Total premises and equipment, net	$21,572	$20,060

Depreciation expense for the years ended December 31, 2015, 2014 and 2013 approximated $1.08 million, $1.07 million, and $1.16 million, respectively.

NOTE 9. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and certain other intangible assets with indefinite useful lives are not amortized into net income over an estimated life, but rather are tested at least annually for impairment. Intangible assets determined to have definite useful lives are amortized over their estimated useful lives and also are subject to impairment testing.

In accordance with ASU 2011-8, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment, which amends Topic 350, Intangibles – Goodwill and Other, entities are permitted to first assess qualitative factors (Step 0) to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-than-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if the entity concludes otherwise, then it is required to perform the first step (Step 1) of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. A fair value is determined based on at least one of three various market valuation methodologies. If the fair value equals or exceeds the book value, no write-down of recorded goodwill is necessary. If the fair value is less than the book value, an expense may be required on our books to write down the goodwill to the proper carrying value. The second step (Step 2) of impairment testing is necessary only if the reporting unit does not pass Step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

During the third quarter, we completed Step 1 of the required annual impairment test for our insurance services reporting unit for 2015 and determined that no impairment write-offs were necessary. We performed the Step 0 qualitative assessment of the goodwill relative to our community banking reporting unit, and determined that it was not more likely than not that the fair value was less than its carrying value and noted no indicators of impairment.

In addition, at December 31, 2015 and December 31, 2014, we had $1.30 million and $1.50 million in unamortized identifiable customer intangible assets recorded in accordance with ASC Topic 805, Business Combinations.

	Goodwill Activity		
Dollars in thousands	Community Banking	Insurance Services	Total
Balance, January 1, 2015	$1,488	$4,710	$6,198
Acquired goodwill, net	—	—	—
Balance, December 31, 2015	$1,488	$4,710	$6,198

	Other Intangible Assets					
	December 31, 2015			December 31, 2014		
Dollars in thousands	Community Banking	Insurance Services	Total	Community Banking	Insurances Services	Total
Unidentifiable intangible assets						
Gross carrying amount	$2,268	$—	$2,268	$2,268	$—	$2,268
Less: accumulated amortization	2,268	—	2,268	2,268	—	2,268
Net carrying amount	$—	$—	$—	$—	$—	$—
Identifiable intangible assets						
Gross carrying amount	$—	$3,000	$3,000	$—	$3,000	$3,000
Less: accumulated amortization	—	1,700	1,700	—	1,500	1,500
Net carrying amount	$—	$1,300	$1,300	$—	$1,500	$1,500

We recorded amortization expense of $200,000 for the year ended December 31, 2015, $250,000 for the year ended December 31, 2014, and $351,000 for the year ended December 31, 2013 relative to our other intangible assets. Annual amortization is expected to be approximately $200,000 for each of the years ending 2016 through 2020.

NOTE 10. DEPOSITS

The following is a summary of interest bearing deposits by type as of December 31, 2015 and 2014:

Dollars in thousands	2015	2014
Demand deposits, interest bearing	$215,721	$204,030
Savings deposits	266,825	253,578
Time deposits	465,153	488,279
Total	$947,699	$945,887

Included in time deposits are deposits acquired through a third party ("brokered deposits") totaling $126.5 million and $146.9 million at December 31, 2015 and 2014, respectively.

A summary of the scheduled maturities for all time deposits as of December 31, 2015 is as follows:

Dollars in thousands	Amount
2016	$219,703
2017	74,574
2018	64,684
2019	35,320
2020	34,628
Thereafter	36,244
Total	$465,153

Time certificates of deposit in denominations of $100,000 or more totaled $342.7 million and $359.2 million at December 31, 2015 and 2014, respectively. The following is a summary of the maturity distribution of all certificates of deposit in denominations of $100,000 or more as of December 31, 2015:

Dollars in thousands	Amount	Percent	
Three months or less	$46,343	13.5	%
Three through six months	53,533	15.6	%
Six through twelve months	54,127	15.8	%
Over twelve months	188,670	55.1	%
Total	$342,673	100.00	%

The aggregate amount of time deposits in denominations that meet or exceed the FDIC insurance limit totaled $154.5 million at December 31, 2015.

At December 31, 2015 and 2014, our deposits of related parties including directors, executive officers, and their related interests approximated $21.2 million and $21.4 million, respectively.

NOTE 11. BORROWED FUNDS

Our subsidiary bank is a member of the Federal Home Loan Bank ("FHLB"). Membership in the FHLB makes available short-term and long-term advances under collateralized borrowing arrangements with each subsidiary bank. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations. We had $92.0 million available on a short term line of credit with the Federal Reserve Bank at December 31, 2015, which is primarily secured by commercial and industrial loans and consumer loans. We also had $6 million available on an unsecured line of credit with a correspondent bank.

At December 31, 2015, our subsidiary banks had combined additional borrowings availability of $377.8 million from the FHLB. Short-term FHLB advances are granted for terms of 1 to 365 days and bear interest at a fixed or variable rate set at the time of the funding request.

Short-term borrowings: At December 31, 2015, we had $98.0 million borrowing availability through credit lines and Federal funds purchased agreements. A summary of short-term borrowings is presented below.

	2015		2014	
Dollars in thousands	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit
Balance at December 31	$167,950	$3,444	$120,950	$2,683
Average balance outstanding for the period	146,412	4,690	94,982	5,804
	171,160	7,438	136,800	8,976

Maximum balance outstanding at any month end during period								
Weighted average interest rate for the period	0.43	%	0.50	%	0.31	%	0.25	%
Weighted average interest rate for balances outstanding at December 31	0.35	%	0.26	%	0.31	%	0.25	%

Federal funds purchased and repurchase agreements mature the next business day. The securities underlying the repurchase agreements are under our control and secure the total outstanding daily balances. We generally account for securities sold under agreements to repurchase as collateralized financing transactions and record them at the amounts at which the securities were sold, plus accrued interest. Securities, generally U.S. government and Federal agency securities, pledged as collateral under these financing arrangements cannot be sold or repledged by the secured party. The fair value of collateral provided is continually monitored and additional collateral is provided as needed.

Long-term borrowings: Our long-term borrowings of $75.6 million and $77.5 million at December 31, 2015 and 2014, respectively, consisted primarily of advances from the FHLB and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

	Balance at December 31,	
Dollars in thousands	2015	2014
Long-term FHLB advances	$873	$977
Long-term reverse repurchase agreements	72,000	72,000
Term loan	2,708	4,513
Total	$75,581	$77,490

The term loan at December 31, 2015 is secured by the common stock of our subsidiary bank, bears a variable interest rate of prime minus 50 basis points with a final maturity of 2017. Our long term FHLB borrowings and reverse repurchase agreements bear both fixed and variable rates and mature in varying amounts through the year 2026.

The average interest rate paid on long-term borrowings during 2015 was 4.39% compared to 4.16% in 2014.

Subordinated debentures: During 2015, we prepaid in full the $16.8 million subordinated debentures that were outstanding at December 31, 2014. The subordinated debt qualified as Tier 2 capital under Federal Reserve Board guidelines until the debt was within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital was reduced by 20 percent each year until maturity. During 2009, we issued $6.8 million in subordinated debt, of which $5 million was issued to an affiliate of a director of Summit. We also issued $1.0 million and $0.8 million to two unrelated parties. These three issuances had an interest rate of 10 percent per annum, a term of 10 years, and were not prepayable by us within the first five years. During 2008, we issued $10 million of subordinated debt to an unrelated institution, which had a variable interest rate of 1 month LIBOR plus 275 basis points and a term of 7.5 years.

Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the "capital securities") for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the "debentures"). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled $19.6 million at December 31, 2015 and 2014.

In October 2002, we sponsored SFG Capital Trust I, in March 2004, we sponsored SFG Capital Trust II, and in December 2005, we sponsored SFG Capital Trust III, of which 100% of the common equity of each trust is owned by us. SFG Capital Trust I issued $3.5 million in capital securities and $109,000 in common securities and invested the proceeds in $3.61 million of debentures. SFG Capital Trust II issued $7.5 million in capital securities and $232,000 in common securities and invested the proceeds in $7.73 million of debentures. SFG Capital Trust III issued $8.0 million in capital securities and $248,000 in common securities and invested the proceeds in $8.25 million of debentures. Distributions on the capital securities issued by the trusts are payable quarterly at a variable interest rate equal to 3 month LIBOR plus 345 basis points for SFG Capital Trust I, 3 month LIBOR plus 280 basis points for SFG Capital Trust II, and 3 month LIBOR plus 145 basis points for SFG Capital Trust III, and equals the interest rate earned on the debentures held by the trusts, and is recorded as interest expense by us. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of the guarantee. The debentures of each Capital Trust are redeemable by us quarterly.

The capital securities held by SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III qualify as Tier 1 capital under Federal Reserve Board guidelines. In accordance with these Guidelines, trust preferred securities generally are limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital.

A summary of the maturities of all long-term borrowings and subordinated debentures for the next five years and thereafter is as follows:

Dollars in thousands	Long-term borrowings	Subordinated debentures owed to unconsolidated subsidiary trusts
2016	$28,911	$—
2017	919	—
2018	45,017	—
2019	18	—
2020	18	—
Thereafter	698	19,589
Total	$75,581	$19,589

NOTE 12. DERIVATIVE FINANCIAL INSTRUMENTS

We use derivative instruments primarily to protect against the risk of adverse interest rate movements on the cash flows of certain liabilities. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based upon a notional amount and an underlying as specified in the contract. A notional amount represents the number of units of a specific item, such as currency units. An underlying represents a variable, such as an interest rate or price index. The amount of cash or other asset delivered from one party to the other is determined based upon the interaction of the notional amount of the contract with the underlying. Derivatives can also be implicit in certain contracts and commitments.

As with any financial instrument, derivative instruments have inherent risks, primarily market and credit risk. Market risk associated with changes in interest rates is managed by establishing and monitoring limits as to the degree of risk that may be undertaken as part of our overall market risk monitoring process. Credit risk occurs when a counterparty to a derivative contract with an unrealized gain fails to perform according to the terms of the agreement. Credit risk is managed by monitoring the size and maturity structure of the derivative portfolio, and applying uniform credit standards to all activities with credit risk.

In accordance with ASC 815, Derivatives and Hedging, all derivative instruments are recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction.

Fair-value hedges – For transactions in which we are hedging changes in fair value of an asset, liability, or a firm commitment, changes in the fair value of the derivative instrument are generally offset in the income statement by changes in the hedged item’s fair value.

Cash-flow hedges – For transactions in which we are hedging the variability of cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument are reported in other comprehensive income. The gains and losses on the derivative instrument, which are reported in comprehensive income, are reclassified to earnings in the periods in which earnings are impacted by the variability of cash flows of the hedged item.

The ineffective portion of all hedges is recognized in current period earnings.

Other derivative instruments – For risk management purposes that do not meet the hedge accounting criteria and, therefore, do not qualify for hedge accounting. These derivative instruments are accounted for at fair value with changes in fair value recorded in the income statement.

We have entered into three forward-starting, pay-fixed/receive LIBOR interest rate swaps. $40 million notional with an effective date of July 18, 2016, was designated as a cash flow hedge of $40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.98% for a 3 year period. $30 million notional with an effective date of April 18, 2016, was designated as a cash flow hedge of $30 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.89% for a 4.5 year period. $40 million notional with an effective date of October 18, 2016, was designated as a cash flow hedge of $40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.84% for a 3 year period.

We have entered into two pay fixed/receive variable interest rate swaps to hedge the fair value variability of two commercial fixed rate loans with the same principal, amortization, and maturity terms of the underlying loans, which are designated as fair value hedges. Under the terms of a $9.95 million notional swap with an effective date of January 15, 2015, we will pay a fixed rate of 4.33% for a 10 year period. Under the terms of an $11.3 million notional swap with an effective date of December 18, 2015, we will pay a fixed rate of 4.30% for a 10 year period.

A summary of our derivative financial instruments as of December 31, 2015 and 2014 follows:

	December 31, 2015			
		Derivative Fair Value		Net Ineffective
Dollars in thousands	Notional Amount	Asset	Liability	Hedge Gains/(Losses)
CASH FLOW HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Long-term borrowings	$110,000	$—	$5,071	$—
FAIR VALUE HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Commercial loans	$21,250	$94	$95	$—

	December 31, 2014			
		Derivative Fair Value		Net Ineffective
Dollars in thousands	Notional Amount	Asset	Liability	Hedge Gains/(Losses)
CASH FLOW HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Long term borrowings	$110,000	$—	$2,911	$—

NOTE 13. INCOME TAXES

The consolidated provision for income taxes includes Federal and state income taxes and is based on pretax net income reported in the consolidated financial statements, adjusted for transactions that may never enter into the computation of income taxes payable. Deferred tax assets and liabilities are determined based on the differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized.

ASC Topic 740 Income Taxes clarifies the accounting and disclosure for uncertain tax positions, as defined. ASC Topic 740 requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. A tax position that fails to meet the probable recognition threshold will result in either reduction of a current or deferred tax asset or receivable, or recording a current or deferred tax liability. ASC Topic 740 also provides guidance on measurement, derecognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions.

The components of applicable income tax expense for the years ended December 31, 2015, 2014 and 2013, are as follows:

Dollars in thousands	2015	2014	2013
Current			
Federal	$6,219	$3,380	$861

State	484	294	41
	6,703	3,674	902
Deferred			
Federal	165	920	1,587
State	25	84	199
	190	1,004	1,786
Total	$6,893	$4,678	$2,688

Reconciliation between the amount of reported income tax expense and the amount computed by multiplying the statutory income tax rates by book pretax income for the years ended December 31, 2015, 2014 and 2013 is as follows:

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Dollars in thousands	2015 Amount	Percent	2014 Amount	Percent	2013 Amount	Percent
Computed tax at applicable statutory rate	$8,048	35	$5,612	35	$3,765	35
Increase (decrease) in taxes resulting from:						
Tax-exempt interest and dividends, net	(1,047)	(4)	(996)	(6)	(932)	(9)
State income taxes, net of Federal income tax benefit	331	1	245	1	156	1
Other, net	(439)	(2)	(183)	(1)	(301)	(3)
Applicable income taxes	$6,893	30	$4,678	29	$2,688	24

Deferred income taxes reflect the impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts as measured for tax purposes. Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the related assets and liabilities are recovered or settled. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized. Our West Virginia net operating loss carryforward expires in 2028.

The tax effects of temporary differences, which give rise to our deferred tax assets and liabilities as of December 31, 2015 and 2014, are as follows:

Dollars in thousands	2015	2014
Deferred tax assets		
Allowance for loan losses	$4,245	$4,128
Depreciation	168	168
Foreclosed properties	4,506	5,197
Deferred compensation	2,554	2,265
Other deferred costs and accrued expenses	387	349
Other-than-temporarily impaired securities	257	257
Net unrealized loss on interest rate swaps	1,876	1,077
NOL and tax credit carryforwards	25	37
Total	14,018	13,478
Deferred tax liabilities		
Accretion on tax-exempt securities	3	8
Net unrealized gain on securities available for sale	1,609	2,297
Purchase accounting adjustments and goodwill	743	806
Total	2,355	3,111
Net deferred tax assets	$11,663	$10,367

In accordance with ASC Topic 740, we concluded that there were no significant uncertain tax positions requiring recognition in the consolidated financial statements. The evaluation was performed for the years ended 2012 through 2015, the tax years which remain subject to examination by major tax jurisdictions.

We may from time to time be assessed interest or penalties associated with tax liabilities by major tax jurisdictions, although any such assessments are estimated to be minimal and immaterial. To the extent we have received an assessment for interest and/or penalties; it has been classified in the consolidated statements of income as a component of other noninterest expense.

We are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2012 through 2014. Tax years 2013 through 2014 remain subject to West Virginia State examination.

NOTE 14. EMPLOYEE BENEFITS

Retirement Plans: We have defined contribution profit-sharing plans with 401(k) provisions covering substantially all employees. Contributions to the plans are at the discretion of the Board of Directors. Contributions made to the plans and charged to expense were $360,000, $362,000, and $354,000 for the years ended December 31, 2015, 2014, and 2013, respectively.

Employee Stock Ownership Plan: We have an Employee Stock Ownership Plan ("ESOP"), which enables eligible employees to acquire shares of our common stock. The cost of the ESOP is borne by us through annual contributions to an Employee Stock Ownership Trust in amounts determined by the Board of Directors.

The expense recognized by us is based on cash contributed or committed to be contributed by us to the ESOP during the year. Contributions to the ESOP for the years ended December 31, 2015, 2014 and 2013 were $429,000, $714,000, and $173,000 respectively. Dividends paid by us to the ESOP are reported as a reduction to retained earnings. The ESOP owned 588,193 and 321,449 shares of our common stock at December 31, 2015 and 2014, respectively, all of which were purchased at the prevailing market price and all but 181,822 unallocated shares at December 31, 2015 are considered outstanding for earnings per share computations.

On July 30, 2015, our ESOP purchased 225,000 shares of Summit Financial Group Inc. common stock in a privately negotiated transaction, at $10.80 per share for a total purchase price of $2,430,000. On July 21, 2015, our Board of Directors approved the company lending to our ESOP $2,250,000 to partially finance the purchase, and was used to purchase 208,333 unallocated shares.

In accordance with ASC 718, Compensation - Stock Compensation, this purchase of unallocated ESOP shares will be shown as a reduction of shareholders' equity, similar to a purchase of treasury stock. The loan receivable from the ESOP to the Company is not reported as an asset nor is the debt of the ESOP reported as a liability on the Company's Consolidated Balance Sheets. Cash dividends on allocated shares (those credited to ESOP participants' accounts) are recorded as a reduction of shareholders' equity and distributed directly to participants' accounts. Cash dividends on unallocated shares (those held by the ESOP not yet credited to participants' accounts) are used to pay a portion of the ESOPs debt service requirements.

Unallocated ESOP shares will be allocated to ESOP participants ratably as the ESOP's loan is repaid. When the shares are committed to be released and become available for allocation to plan participants, the then fair value of such shares will be charged to compensation expense. Unallocated shares owned by the Company's ESOP are not considered to be outstanding for the purpose of computing earnings per share.

The ESOP shares as of December 31 are as follows:

ESOP Shares	At December 31,	
	2015	2014
Allocated shares	379,860	321,449
Shares committed to be released	26,511	—
Unallocated shares	181,822	—
Total ESOP shares	588,193	321,449
Market value of unallocated shares (in thousands)	$2,160	$—

Supplemental Executive Retirement Plan: In May 1999, Summit Community Bank entered into a non-qualified Supplemental Executive Retirement Plan ("SERP") with certain senior officers, which provides participating officers with an income benefit payable at retirement age or death. During 2000, Shenandoah Valley National Bank adopted a similar plan and during 2002, Summit Financial Group, Inc. adopted a similar plan. The liabilities accrued for the SERP's at December 31, 2015 and 2014 were $4.3 million and $3.9 million, respectively, which are included in other liabilities.

Share Based Compensation: The 2014 Long-Term Incentive Plan ("2014 LTIP") was adopted by our shareholders in May 2014 to enhance the ability of the Company to attract and retain exceptionally qualified individuals to serve as key employees. The LTIP provides for the issuance of up to 500,000 shares of common stock, in the form of equity awards including stock options, restricted stock, restricted stock units, stock appreciation rights ("SARs"), performance units, other stock-based awards or any combination thereof, to our key employees.

Stock options awarded under the 2009 Officer Stock Option Plan and the 1998 Officer Stock Option Plan (collectively, the “Plans”) were not altered by the 2014 LTIP, and remain subject to the terms of the Plans. However, under the terms of the 2014 LTIP, all shares of common stock remaining issuable under the Plans at the time the 2014 LTIP was adopted ceased to be available for future issuance.

Under the 2014 LTIP and the Plans, stock options and SARs have generally been granted with an exercise price equal to the fair value of Summit's common stock on the grant date. We periodically grant share based compensation to individual employees. During second quarter 2015, we granted 166,717 SARs that become exercisable ratably over five years (20% per year) and expire ten years after the grant date. There were no grants of stock options in 2015 and no grants of stock options or SARs in 2014.

The fair value of our employee stock options and SARs granted under the Plans is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options and SARs granted but are not considered by the model. Because our employee stock options and SARs have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and SARs at the time of grant. The assumptions used to value SARs issued during 2015 were a risk-free interest rate of 1.96%, an expected dividend yield of 2.75%, an expected common stock volatility of 61.84%, and an expected life of 10 years.

We recognize compensation expense based on the estimated number of stock awards expected to actually vest, exclusive of the awards expected to be forfeited. During 2013, 2014, and 2015, our stock compensation expense and related deferred taxes were insignificant.

A summary of activity in our Plans during 2013, 2014 and 2015 is as follows:

	Options / SARs		Weighted-Average Exercise Price (WAEP)
Outstanding, December 31, 2012	249,700		$18.98
Granted	—		—
Exercised	(17,800	)	5.37
Forfeited	(1,750	)	19.69
Expired	(44,740	)	21.83
Outstanding, December 31, 2013	185,410		$19.59
Granted	—		—
Exercised	(10,160	)	6.98
Forfeited	(6,500	)	24.44
Expired	(11,580	)	16.64
Outstanding, December 31, 2014	157,170		$20.43
Granted	166,717		12.01
Exercised	(6,560	)	7.87
Forfeited	—		—
Expired	(73,180	)	23.67
Outstanding, December 31, 2015	244,147		$14.05
Exercisable Options/SARs:			
December 31, 2015	77,430		$18.43
December 31, 2014	156,170		$20.54
December 31, 2013	182,810		$19.24

Other information regarding awards outstanding and exercisable at December 31, 2015 is as follows:

	Options/SARs Outstanding				Options/SARs Exercisable		
Range of exercise price	# of awards	WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of awards	WAEP	Aggregate Intrinsic Value (in thousands)
$ 2.54 - $ 6.00	7,750	$3.75	5.18	$63	7,750	$3.75	$63
6.01 - 10.00	12,680	8.71	2.65	40	12,680	8.71	40
10.01 - 17.50	166,717	12.01	9.32	—	—	—	—
17.51 - 20.00	23,400	17.80	2.00	—	23,400	17.80	—
20.01 - 25.93	33,600	25.93	2.44	—	33,600	25.93	—
	244,147	$14.05		$103	77,430	$18.43	$103

NOTE 15. COMMITMENTS AND CONTINGENCIES

Off-Balance Sheet Arrangements

We are a party to certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments reflect the extent of involvement that we have in this class of financial instruments.

Many of our lending relationships contain both funded and unfunded elements. The funded portion is reflected on our balance sheet. The unfunded portion of these commitments is not recorded on our balance sheet until a draw is made under the loan facility. Since many of the commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements.

A summary of the total unfunded, or off-balance sheet, credit extension commitments follows:

Dollars in thousands	December 31, 2015
Commitments to extend credit:	
Revolving home equity and credit card lines	$58,008
Construction loans	32,044
Other loans	49,775
Standby letters of credit	5,302
Total	$145,129

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if we deem necessary upon extension of credit, is based on our credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

Operating leases: We occupy certain facilities under long-term operating leases. The aggregate minimum annual rental commitments under those leases total approximately $256,000 in 2016 and $215,000 in 2017. Total net rent expense included in the accompanying consolidated financial statements was $285,000 in 2015, $291,000 in 2014, and $278,000 in 2013.

Litigation: We are involved in various legal actions arising in the ordinary course of business. To the best of our knowledge, no matters have been specifically identified to management that are reasonably possible to have a significant adverse effect on the consolidated financial statements.

Employment Agreements: We have various employment agreements with our chief executive officer and certain other executive officers. These agreements contain change in control provisions that would entitle the officers to receive compensation in the event there is a change in control in the Company (as defined) and a termination of their employment without cause (as defined).

Legal Contingencies

On May 13, 2014, the ResCap Liquidating Trust ("ResCap"), as successor to Residential Funding Company, LLC f/k/a Residential Funding Corporation ("RFC"), filed a complaint against Summit Financial Mortgage, LLC ("Summit Mortgage"), a former residential mortgage subsidiary of Summit whose operations were discontinued in 2007, in the United States Bankruptcy Court for the Southern District of New York and subsequently amended its complaint on July 25, 2014. The Amended Complaint asserts the following three causes of action related to Summit Mortgage's origination and subsequent sale of mortgage loans to Residential Funding Corporation: 1) Summit Mortgage breached its representations and warranties made in the contract governing the sale of the mortgage loans to RFC; 2) an indemnification claim against Summit Mortgage for damages paid by ResCap to settle claims in RFC's bankruptcy proceeding which allegedly relate to mortgage loans Summit Mortgage sold to RFC; 3) a claim for damages against Summit Community Bank, Inc., former parent of Summit Mortgage, arising out of a guaranty in which the Bank guaranteed Summit Mortgage's full performance under the contract governing the sale of mortgage loans to RFC. Summit has filed a motion to dismiss the case. Based upon the applicable statute of limitations, the Court granted our motion to dismiss the breach of contract claim with respect to loans Summit sold to RFC prior to March 14, 2006. The court otherwise denied our motion to dismiss on the grounds that the other arguments raised factual questions that could not be decided on a motion to dismiss. An estimate as to possible loss resulting from the Amended Complaint cannot be provided at this time because such an estimate cannot be made. Summit intends to defend these claims vigorously.

We are not a party to any other litigation except for matters that arise in the normal course of business. While it is impossible to ascertain the ultimate resolution or range of financial liability with respect to these contingent matters, in the opinion of management, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

NOTE 16. PREFERRED STOCK

On March 12, 2015, we converted all outstanding shares of our 8% Non-Cumulative Convertible Preferred Stock, Series 2009, $1.00 par value, with a liquidation preference of $1,000 per share (the "Series 2009 Preferred Stock") and our 8% Non-Cumulative Convertible Preferred Stock, Series 2011, $1.00 par value, with a liquidation preference of $500 per share (the "Series 2011 Preferred Stock") to common shares.

On September 30, 2009, we sold in a private placement 3,710 shares, or $3.7 million, of 8% Non-Cumulative Convertible Preferred Stock, Series 2009, $1.00 par value, with a liquidation preference of $1,000 per share (the "Series 2009 Preferred Stock"), based on the private placement exemption under Section 4(2) of the Securities Act of 1933 (the "Securities Act") and Rule 506 of Regulation D.

The terms of the Series 2009 Preferred Stock provided that it may have been converted into common stock under three different scenarios. First, the Series 2009 Preferred Stock may have been converted at the holder's option, on any dividend payment date, at the option of the holder, into shares of common stock based on a conversion rate determined by dividing $1,000 by $5.50, plus cash in lieu of fractional shares and subject to anti-dilution adjustments (the "Series 2009 Conversion Rate"). Second, on or after June 1, 2012, Summit may have, at its option, on any dividend payment date, converted some or all of the Series 2009 Preferred Stock into shares of Summit's common stock at the applicable Series 2009 Conversion Rate. Summit could have exercised this conversion right if, for 20 trading days within any period of 30 consecutive trading dates during the six months immediately preceding the conversion, the closing price of the common stock exceeded 135% of $5.50. Third, after ten years, on June 1, 2019, all remaining outstanding shares of the Series 2009 Preferred Stock would have been converted at the applicable Series 2009 Conversion Rate. Adjustments to the Series 2009 Conversion Rate would have been made in the event of a stock dividend, stock split, reclassification, reorganization, merger or other similar transaction.

In late 2011, we sold pursuant to both subscription rights distributed to our common shareholders and to a supplemental public offering 12,000 shares, or $6.0 million, of 8% Non-Cumulative Convertible Preferred Stock, Series 2011, $1.00 par value, with a liquidation preference of $500 per share (the "Series 2011 Preferred Stock").

The terms of the Series 2011 Preferred Stock also provided that it may have been converted into common stock under three different scenarios. First, the Series 2011 Preferred Stock may have been converted at the holder's option, on any dividend payment date, at the option of the holder, into shares of common stock based on a conversion rate determined by dividing $500 by $4.00, plus cash in lieu of fractional shares and subject to anti-dilution adjustments (the "Series 2011 Conversion Rate"). Second, on or after June 1, 2014, Summit may have, at its option, on any dividend payment date, converted some or all of the Series 2011 Preferred Stock into shares of Summit's common stock at the applicable Series 2011 Conversion Rate. Summit may have exercised this conversion right if, for 20 trading days during the 30 consecutive trading days immediately preceding the date of notice of the conversion, the closing price of the common stock exceeded 135% of $4.00. Third, after ten years, on June 1, 2021, all remaining outstanding shares of the Series 2011 Preferred Stock would have converted at the applicable Series 2011 Conversion Rate. Adjustments to the Series 2011 Conversion Rate would have been made in the event of a stock dividend, stock split, reclassification, reorganization, merger or other similar transaction.

Both the Series 2009 and Series 2011 Preferred Stock paid noncumulative dividends, if and when declared by the Board of Directors, at a rate of 8.0% per annum. Dividends declared were payable quarterly in arrears on the 1st day of March, June, September and December of each year. The Series 2009 and Series 2011 Preferred Stock qualified as Tier 1 capital for regulatory capital purposes.

NOTE 17. COMMON STOCK ISSUANCES

We entered into a Securities Purchase Agreement ("SPA") with Castle Creek Capital Partners V, LP ("Castle Creek") on August 25, 2014. In accordance with the terms of the SPA, we agreed to sell 1,057,137 shares of common stock (representing approximately 9.9% of our outstanding common stock) at the price of $9.75 per share to Castle Creek in a private placement. The private placement with Castle Creek consisted of two (2) closings. The first closing for the purchase of 819,384 shares of common stock at an aggregate price of $7,988,994 was consummated on November 25, 2014. The second closing for the purchase of 237,753 shares of common stock at an aggregate price of $2,318,092 was consummated on March 17, 2015 and was conditioned upon, among other things, the conversion into shares of common stock of all of the outstanding shares of our 8% Non-Cumulative Convertible Preferred Stock, Series 2009 and our 8% Non-Cumulative Convertible Preferred Stock, Series 2011 ("the Conversions"), in accordance with the terms of our Articles of Incorporation, as amended.

We also agreed under the terms of the SPA to commence, following the second closing of the sale of Common Stock to Castle Creek under the SPA, a rights offering (the "Rights Offering") to the holders of record of the Common Stock as of a date selected by Summit's Board of Directors. In the Rights Offering, all holders of Common Stock as of the record date, excluding Castle Creek, were offered non-transferable rights ("Rights") to purchase shares of Common Stock at the same per share purchase price of $9.75 used in the Private Placement to Castle Creek. The aggregate number of shares that offered for sale in connection with the Rights Offering was 256,410 with 256,167 shares being issued yielding total gross proceeds of approximately $2.5 million, prior to any fees and expenses associated with the sale. The Rights were distributed to all of the holders of the Common Stock, excluding Castle Creek, on a pro rata basis, based on the number of shares of Common Stock owned by each shareholder as of April 10, 2015, the record date used in connection with the Rights Offering. The Rights Offering expired May 29, 2015.

NOTE 18. REGULATORY MATTERS

The primary source of funds for our dividends paid to our shareholders is dividends received from our subsidiaries. Dividends paid by the subsidiary bank are subject to restrictions by banking law and regulations and require approval by the bank's regulatory agency if dividends declared in any year exceed the bank's current year's net income, as defined, plus its retained net profits of the two preceding years. During 2016, the Bank will have $12.8 million plus net income for the interim periods through the date of declaration, available for dividends for distribution to us.

We and our subsidiaries are subject to various regulatory capital requirements administered by the banking regulatory agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we and each of our subsidiaries must meet specific capital guidelines that involve quantitative measures of our and our subsidiaries' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. We and each of our subsidiaries' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of December 31, 2015, that we and our subsidiaries met all capital adequacy requirements to which they were subject.

The most recent notifications from the banking regulatory agencies categorized us and each of our subsidiaries as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, we and each of our subsidiaries must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below.

Our subsidiary banks are required to maintain reserve balances with the Federal Reserve Bank. The required reserve balance was $629,000 at December 31, 2015.

Our actual capital amounts and ratios as well as our subsidiary, Summit Community Bank's ("Summit Community") are presented in the following table.

	Actual			Minimum Required Capital - Basel III Fully Phased-in			Minimum Required To Be Well Capitalized		
Dollars in thousands	Amount	Ratio		Amount	Ratio		Amount	Ratio	
As of December 31, 2015									
CET1 (to risk weighted assets)									
Summit	$137,849	11.8	%	$81,775	7.0	%	$75,934	6.5	%
Summit Community	158,081	13.6	%	81,365	7.0	%	75,553	6.5	%
Tier I Capital (to risk weighted assets)									
Summit	156,849	13.4	%	99,494	8.5	%	93,641	8.0	%
Summit Community	158,081	13.6	%	98,801	8.5	%	92,989	8.0	%
Total Capital (to risk weighted assets)									
Summit	168,321	14.4	%	122,734	10.5	%	116,890	10.0	%
Summit Community	169,553	14.5	%	122,780	10.5	%	116,933	10.0	%
Tier I Capital (to average assets)									
Summit	156,849	10.7	%	58,635	4.0	%	73,294	5.0	%
Summit Community	158,081	10.8	%	58,549	4.0	%	73,186	5.0	%
As of December 31, 2014									
Tier I Capital (to risk weighted assets)									
Summit	141,589	13.3	%	42,583	4.0	%	63,875	6.0	%
Summit Community	150,653	14.2	%	42,437	4.0	%	63,656	6.0	%
Total Capital (to risk weighted assets)									
Summit	158,196	14.9	%	84,937	8.0	%	106,172	10.0	%
Summit Community	161,820	15.3	%	84,612	8.0	%	105,765	10.0	%
Tier I Capital (to average assets)									
Summit	141,589	9.9	%	57,208	4.0	%	71,510	5.0	%
Summit Community	150,653	10.6	%	56,850	4.0	%	71,063	5.0	%

NOTE 19. SEGMENT INFORMATION

We operate two business segments: community banking and insurance & financial services. These segments are primarily identified by the products or services offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through various delivery channels. The insurance & financial services segment includes three insurance agency offices that sell insurance products. The accounting policies discussed throughout the notes to the consolidated financial statements apply to each of our business segments.

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Inter-segment revenue and expense consists of management fees allocated to the community banking and the insurance & financial services segments for all centralized functions that are performed by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

	December 31, 2015				
Dollars in thousands	Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income	$46,744	$—	$(728)	$—	$46,016
Provision for loan losses	1,250	—	—	—	1,250
Net interest income after provision for loan losses	45,494	—	(728)	—	44,766
Other income	7,324	4,537	1,133	(1,133)	11,861
Other expenses	28,060	4,315	2,390	(1,133)	33,632
Income (loss) before income taxes	24,758	222	(1,985)	—	22,995
Income tax expense (benefit)	7,542	43	(692)	—	6,893
Net income (loss)	17,216	179	(1,293)	—	16,102
Dividends on preferred shares	—	—	—	—	—
Net income (loss) applicable to common shares	$17,216	$179	$(1,293)	$—	$16,102
Inter-segment revenue (expense)	$(1,047)	$(86)	$1,133	$—	$—
Average assets	$1,496,396	$5,923	$167,839	$(203,571)	$1,466,587

	December 31, 2014				
Dollars in thousands	Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income	$44,209	$—	$(1,824)	$—	$42,385
Provision for loan losses	2,250	—	—	—	2,250
Net interest income after provision for loan losses	41,959	—	(1,824)	—	40,135
Other income	6,299	4,882	1,231	(1,189)	11,223
Other expenses	30,579	4,188	1,746	(1,189)	35,324
Income (loss) before income taxes	17,679	694	(2,339)	—	16,034
Income tax expense (benefit)	5,191	226	(739)	—	4,678
Net income (loss)	12,488	468	(1,600)	—	11,356
Dividends on preferred shares	—	—	771	—	